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# The Making of General Support Grants Within the Confines of Expenditure Responsibility: A Deviation from Standard Legal Interpretation

Rachel Gillette

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# THE MAKING OF GENERAL SUPPORT GRANTS WITHIN THE CONFINES OF EXPENDITURE RESPONSIBILITY: A DEVIATION FROM STANDARD LEGAL INTERPRETATION

*Rachel Gillette\**

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\* J.D. Recipient, 2018, Fordham University School of Law, Evening Division. Rachel also formerly worked with the Open Society Foundations. Though surely influenced by the way that the Open Society Foundations interpret the legal framework discussed in this Note, the views expressed in this Note are the author’s alone and are the product of independent research.

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## INTRODUCTION

It is an all too common story: A new organization with a fresh approach bursts onto the nonprofit scene, shaking up the status quo and spurring great leaps forward on their issue of choice, seeming to make every dollar support greater impact than was possible ever before. And yet, despite the ability to attract consistent funding and inspire its peers, the organization shutter just years after its

founding.<sup>1</sup> Consider FORGE, an organization that helped over 70,000 refugees in Zambia and Botswana to build both short-term and long-term capacity by supporting initiatives developed by the beneficiaries themselves.<sup>2</sup> Such initiatives included building libraries, developing computer literacy and training programs, and establishing micro-financing for agricultural workers.<sup>3</sup> Despite FORGE's meaningful impact and responsive approach to its work, it closed after a modest nine years.<sup>4</sup> The self-reported cause of their closure: a lack of unrestricted funding and, as a result, underinvestment in the internal infrastructure necessary to maintain the organization.<sup>5</sup>

Dubbed the “Nonprofit Starvation Cycle” by the Stanford Social Innovation Review, the cycle of underfunded nonprofits continues.<sup>6</sup> There are a variety of reasons for this cycle: funders and nonprofits alike conflate higher overhead with reduced impact; grant-making foundations<sup>7</sup> are reticent to provide more flexible funding; or, due to restrictions placed on how grants to international organizations can be made, funders are under the false perception that the only way to make grants is through restricted project grants<sup>8</sup> that do not allow for investments in organizational infrastructure.<sup>9</sup> Though the problem

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1. See, e.g., Kjerstin Erickson, *Nonprofit Emaciation: Confessions of a Do-Gooder Who Starved an Organization*, ROOT CAUSE: PERSPECTIVES BLOG (Nov. 2004), <http://www.rootcause.org/blog/nonprofit-emaciation-confessions-of-a-do-gooder-who-starved-an-organization> [<https://perma.cc/6YWN-UA9P>].

2. See *id.*

3. See *id.*

4. See *id.* at 2. While lifetimes of NGOs vary depending on the sector, most NGOs seek a lifetime that spans decades rather than years in order to build and sustain change over time. E.g., Randolph Kent et al., *The Future of NonGovernmental Organisations in the Humanitarian Sector*, HUMANITARIAN FUTURES PROGRAMME, at 3 (Aug. 2013), <http://www.humanitarianfutures.org/wp-content/uploads/2013/09/The-Future-of-Humanitarian-NGOs-HFP-Discussion-Paper-Aug2013.pdf> [<https://perma.cc/8MRU-HQHM>] (noting that many NGOs in the humanitarian sector are reaching the age of fifty).

5. See Erickson, *supra* note 1.

6. See Ann Goggins Gregory & Don Howard, *The Nonprofit Starvation Cycle*, STAN. SOC. INNOVATION REV. (2009), at 49–50, [http://ssir.org/articles/entry/the\\_nonprofit\\_starvation\\_cycle](http://ssir.org/articles/entry/the_nonprofit_starvation_cycle) [<https://perma.cc/99JU-2AZM>].

7. For the purposes of this Note, the term “foundation” refers to private foundations, as well as both operating and non-operating foundations who operate grant making programs. See *Knowledge Base: What Is the Difference Between a Private Foundation and a Public Charity?*, GRANTSPACE, <http://grantspace.org/tools/knowledge-base/Funding-Resources/Foundations/private-foundations-vs-public-charities> [<https://perma.cc/7F3N-J29M>] (defining “Private foundations”).

8. See *infra* Section I.B.1.

9. See *infra* Section I.B.1.

likely stems from some combination of these issues, this Note focuses on the latter two issues.

Funders *are* beginning to acknowledge the issues raised above, and there is a growing movement to provide greater flexibility in the grants that they make.<sup>10</sup> This flexibility ensures that grantees can remain responsive to the field and effective in creating the change that both the grantee and the grantor want to see in society, while also building the institutional capacity necessary to function and adapt to each organization's constantly changing environment most effectively.<sup>11</sup> The most common way for a foundation to provide this flexibility is through a general support grant—a grant in which funds are not tied to particular budget lines or outcomes, and instead provides the grantee with flexibility to determine how funds are expended.<sup>12</sup> This approach stands in sharp contrast to project-support grants—the more typical approach to grant making—where funds are tied to particular outcomes and budget lines and, if the grantee desires to shift funds between budget-lines, they must receive prior approval from the funder.<sup>13</sup>

For foundations that have an international focus, however, providing general support grants is typically understood to be a rare possibility. When a foundation<sup>14</sup> is funding an organization that is not

10. See *infra* Section I.B.1; see also *The Beauty of the General Support Grant*, GRANTCRAFT (Mar. 1, 2005), <http://www.grantcraft.org/takeaways/the-beauty-of-the-general-support-grant> [https://perma.cc/9VXR-DPPW]; J MCCRAY, GRANTMAKERS FOR EFFECTIVE ORGANIZATIONS, IS GRANTMAKING GETTING SMARTER?: A NATIONAL STUDY OF PHILANTHROPIC PRACTICE 7 (2014), <https://www.giarts.org/sites/default/files/Is-Grantmaking-Getting-Smarter.pdf> [https://perma.cc/8B7Z-F3T6].

11. See generally Gregory & Howard, *supra* note 6, at 53; *The Beauty of the General Support Grant*, *supra* note 10; see also MCCRAY, *supra* note 10, at 7, 23.

12. See, e.g., *General Operating Support (or Unrestricted) Grants*, GRANTCRAFT (Feb. 26, 2015), <http://www.grantcraft.org/takeaways/general-operating-support-or-unrestricted-grants> [https://perma.cc/2E2R-MBRT] (discussing how general support allows grantees to “invest” in themselves by building capacity or investing in new areas of work); *Unrestricted Core Support: Strengthening the Capacity of Our Nonprofit Sector*, GRANTCRAFT (Oct. 15, 2013), <http://www.grantcraft.org/blog/unrestricted-core-support-strengthening-the-capacity-of-our-nonprofit-secto> [https://perma.cc/XAD7-9RCV] (“... [C]ore support funding provides nonprofit organizations with the working capital necessary to sustain day-to-day operations and to build a well-managed and fully operational infrastructure.”); see *infra* Section I.B.2.

13. E.g., *The Beauty of the General Support Grant*, *supra* note 10 (“Engage grantees more, but put fewer restrictions on their money.’ If the money isn’t restricted, then you don’t have to get into silly dances about how they met the letter of the contract and you met the letter of the tax laws, and you can really engage them about how to be as effective as possible.”); see *infra* Section I.B.1.

14. See *infra* Section I.A.

a registered 501(c)(3) public charity<sup>15</sup> (which encompasses many international organizations), they must adhere to a particular set of rules under a framework called expenditure responsibility.<sup>16</sup> While these rules seek to ensure that funds are spent for charitable purposes, they are consistently interpreted to be quite limiting in terms of the amount of flexibility that foundations can provide to grantees.<sup>17</sup> This Note argues that there is greater potential for flexibility in the interpretation of the expenditure responsibility rules than practitioners commonly recognize. Accordingly, this Note is dedicated to offering an interpretation for how foundations can make general support grants under the expenditure responsibility rules while staying within the margins of pre-existing law. Section I.A of this Note explores some background on what foundations are, their role in society, and how they foster change through grant making. Following an explanation in Section I.B of the basic types of grants that foundations can provide, Section I.C then explores the particular legal framework that governs grant making to international organizations. In Part II, this Note identifies the sources of tension between common foundation practice and the plain text of the law with regards to general support in the expenditure responsibility context, and offers a variety of legal and policy explanations for both why it is and is not appropriate to interpret the expenditure responsibility requirements in a manner that allows for general support grant making. In Part III, this Note offers three potential approaches to providing a general support grants under the expenditure responsibility rules and several recommendations to the Internal Revenue Service (“IRS”) for how to clarify relevant regulations to confirm that the proposed approaches rest on solid legal ground.

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15. A 501(c)(3) organization is organized and operated for charitable, educational, religious, scientific, or other reasons specified in §501(c)(3) of the U.S. Tax Code. *See infra* note 20.

16. *See generally* 26 U.S.C. § 4945 (2014); 26 C.F.R. § 53.4945-5 (2018); IRM 7.27.19 (Feb. 22, 1999); *see infra* Section I.C.

17. *See, e.g.*, LISA NORTON, HOW TO BE A GLOBAL NONPROFIT: LEGAL AND PRACTICAL GUIDANCE FOR INTERNATIONAL ACTIVITIES 49 (2012) (“Expenditure responsibility can only be used when a grant is made for a specific, preapproved project.”); *see also* JODY BLAZEK, TAX PLANNING AND COMPLIANCE FOR TAX-EXEMPT ORGANIZATIONS 492 (5th ed. 2012) (noting that grant terms must “clearly state the purpose for the grant”).

## I. PRIVATE FOUNDATIONS

Part I provides an overview of private foundations, including what foundations are, their role in society, and how they foster change through grant making. Part I then proceeds to explain the basic types of grants that foundations can provide before exploring the particular legal framework that governs grant making to international organizations.

### A. Foundations and Their Role in Civil Society

A private foundation is a tax-exempt organization established for a charitable purpose, generally by one person or family with a large amount of wealth.<sup>18</sup> Foundations seek to foster change in the world and wield their influence through the disbursement of funds to other organizations or individuals with a deep commitment to and expertise in the chosen area of concern.<sup>19</sup> Charitable purposes are any activities that seek to provide:

relief of the poor, the distressed, or the underprivileged;  
advancement of religion; advancement of education or science;  
erecting or maintaining public buildings, monuments, or works;  
lessening the burdens of government; lessening neighborhood  
tensions; eliminating prejudice and discrimination; defending human  
and civil rights secured by law; and combating community  
deterioration and juvenile delinquency.<sup>20</sup>

Along the same lines, foundations are not allowed to engage in lobbying activities or political campaigns.<sup>21</sup> Put simply, being charitable means that an organization is serving a “public rather than a private interest.”<sup>22</sup>

Foundations are regulated by the IRS and must follow relevant aspects of the U.S. Tax Code, the Code of Federal Regulations (the “C.F.R.”), and a series of IRS guidelines shared in the Internal

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18. See *Foundation Basics*, COUNCIL ON FOUNDATIONS, [http://www.cof.org/content/foundation-basics#what\\_is\\_a\\_foundation](http://www.cof.org/content/foundation-basics#what_is_a_foundation) [https://perma.cc/E6TC-PTYU].

19. See *id.*

20. *Exempt Purposes – Internal Revenue Code Section 501(c)(3)*, INTERNAL REVENUE SERVICE, <https://www.irs.gov/charities-non-profits/charitable-organizations/exempt-purposes-internal-revenue-code-section-501c3> [https://perma.cc/P59M-FQ2C].

21. See 26 U.S.C. § 4945(d) (2014).

22. MICHAEL I. SANDERS, JOINT VENTURES INVOLVING TAX-EXEMPT ORGANIZATIONS 107 (4th ed. 2013); see also 26 U.S.C. § 501(c)(3) (2018).

Revenue Manual (the “I.R.M.”).<sup>23</sup> Given the positive potential impact of foundations, the U.S. government has incentivized the creation of and donation to foundations by making those contributions tax deductible.<sup>24</sup> There is contradictory evidence about whether or not the tax deductible nature of donations has a positive, neutral, or even negative impact on the amount of donations made to foundations;<sup>25</sup> however, tax deductibility is generally seen as a positive incentive.<sup>26</sup> For existing foundations, tax-exempt status is generally viewed as crucial to their long-term survival; therefore, foundations have every incentive to adhere to the IRS regulations governing how their tax deductible dollars can be spent in order to retain their tax-exempt status.<sup>27</sup>

Private foundations have played—and continue to play—a key role in civil society, providing resources for underfunded interests and innovation, pushing the status quo, and supporting a diversity of viewpoints in society at-large.<sup>28</sup> By virtue of their concentrated wealth, foundations hold a nearly unmatched ability to channel resources towards the provision of crucial support and services in sectors where the government cannot or chooses not to provide support.<sup>29</sup> In fact, this ability to fill the gaps left by the government is often recognized as the justification for providing foundations with tax exemption.<sup>30</sup>

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23. *See generally* 26 U.S.C. § 4945(d) (2014); 26 C.F.R. § 53.4945-5 (2015); IRM 7.27.19 (Feb. 22, 1999).

24. *See* 26 U.S.C. § 501(c)(3) (2018).

25. *See* RANDALL G. HOLCOMBE, *WRITING OFF IDEAS: TAXATION, FOUNDATIONS, AND PHILANTHROPY IN AMERICA* 87 (1st ed. 2000) (“... the tax system has the potential to exert a significant influence on the resources that flow into the nonprofit sector of the economy, although predictions that if tax deductibility of contributions were eliminated the sector would lose most of its funding are likely to be overstated.”).

26. *See id.*

27. *See id.*

28. *E.g.*, Barry Gaberman, *The Role of Foundations in Society*, ALLIANCE MAG., Sept. 1, 2006, <http://www.alliancemagazine.org/article/the-role-of-foundations-in-society/> [<https://perma.cc/R97M-LC68>]; JOAN E. SPERO, FOUNDATION CENTER, *THE GLOBAL ROLE OF U.S. FOUNDATIONS* 33 (2010), [http://foundationcenter.org/gainknowledge/research/pdf/global\\_role\\_of\\_us\\_foundationns.pdf](http://foundationcenter.org/gainknowledge/research/pdf/global_role_of_us_foundationns.pdf) [<https://perma.cc/5WVF-U6S6>] (“What foundations can do is to identify gaps, needs, and niches where their resources can contribute to pieces of the problem, to aspects of social, economic, and political change . . .”); Carl Schramm, *Law Outside the Market: The Social Utility of Private Foundations*, 30 HARV. J. L. & PUB. POL’Y 355, 358–62 (2006).

29. *See* HOLCOMBE, *supra* note 25, at 2.

30. *See* SANDERS, *supra* note 22, at 102 n.299 (“[T]he exemption from taxation of money or property devoted to charitable or other purposes is based upon the theory



Foundations also resource innovation, fostering important strides in social progress by funding thinkers, innovators, and social pioneers in fields ranging from medicine to the arts. Funding “laboratories” of experimentation, foundations can help find solutions to some of society’s biggest challenges that, once found, can then be outsourced to the government or other service providers who cannot afford to undertake such experimentation themselves.<sup>31</sup> Andrew Carnegie—forefather of one of the most prominent modern-day foundations—is credited with the provocative quote that “wealth, passing through the hands of the few, can be made a much more potent force for the elevation of our race than if it had been distributed in small sums to the people themselves.”<sup>32</sup> Though controversial, this statement does illustrate the potency with which foundations can contribute to the broader public good.

There are many examples of the impact that foundations have made on particular issues, in particular fields and movements, and in the world, generally. For example, the Kellogg Foundation, an institution that provides higher education for roughly ten million students per year, was an initial funder of community colleges in the United States.<sup>33</sup> In the field of public health, foundations such as the Gates Foundation and the Rockefeller Foundation have provided AIDS medication to tens of thousands of individuals, funded public education campaigns that have focused on awareness of the HIV/AIDS epidemic, and supported public-private partnerships to search for a vaccine to the disease.<sup>34</sup> Foundations can also play a crucial role in global politics: through funding the building of libraries in the former Soviet Union, the Open Society Foundations helped

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that the government is compensated for the loss of revenue by its relief from financial burdens which would otherwise have to be met by appropriations from other public funds, and by the benefits resulting from the promotion of the general welfare.”).

31. See Schramm, *supra* note 28; see also HOLCOMBE, *supra* note 25, at 28 (discussing foundations’ ability to examine the causes of problems rather than simply attempting to treat the problem).

32. Christopher Caldwell, *Donor Beware: The New Realities of Philanthropy*, WALL ST. J. (Mar. 11, 2016), <http://www.wsj.com/articles/donor-beware-the-new-realities-of-philanthropy-1457721449> [<https://perma.cc/6VHS-46DG>].

33. See *Foundation Growth*, W.K. KELLOGG FOUNDATION, <https://www.wkkf.org/who-we-are/history-legacy> [<https://perma.cc/D83R-L2YZ>].

34. See *HIV Strategy Overview*, GATES FOUNDATION, <http://www.gatesfoundation.org/What-We-Do/Global-Health/HIV> [<https://perma.cc/5FPC-DM27>]; *HIV/AIDS*, ROCKEFELLER FOUNDATIONS, <https://rockfound.rockarch.org/hiv/aids> [<https://perma.cc/VMF3-F9E4>].

bolster people's movements that ultimately led to the fall of the Soviet regime.<sup>35</sup>

On the other hand, the same concentration of wealth that allows private foundations to have the impact described above is also why private foundations have been the target of continuous skepticism since their inception. The impetus for this skepticism is two-fold. First, foundations are financially independent in that they generally have one individual or family of donors who provide their funding.<sup>36</sup> By placing those funds into an endowment, the funds become self-sustaining over time with little room for regulation.<sup>37</sup> Second, and related to the first issue, private foundations are broadly perceived to lack accountability.<sup>38</sup> Many charitable organizations are perceived as accountable to the public because the organization relies on the general public to be its donors; therefore, in order to ensure continued funding, organizations shift their strategies to remain consistent with what the public believes is the best use of charitable assets.<sup>39</sup> In contrast, foundations are financially independent; therefore, they are not subject to the same pressure to alter their strategies to the public's preferences and could, ostensibly, undertake activities in the name of the public good that the public, themselves, do not desire.<sup>40</sup>

## B. Foundation Grant Making

The main tool through which private foundations seek to foster social change is through the disbursement of funds to organizations and individuals through a mechanism called a grant. Grants are

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35. See *About Us, History*, OPEN SOCIETY FOUNDATIONS, <https://www.opensocietyfoundations.org/about/history> [https://perma.cc/44EY-VYPM].

36. See *Foundation Basics*, *supra* note 18.

37. See HOLCOMBE, *supra* note 25, at 2 (“Foundations become wealthier and wealthier, and continue to undertake expenditures to further *their* visions of the public good.”).

38. See, e.g., *id.* at 3 (“The perceived problems stem from the fact that a small group of foundation trustees are able to control a substantial amount of money that can have an impact on political and social policy without being accountable to anyone for their actions. The money is not theirs. It was earned by others who, for the most part, have long been dead. Now control of these fortunes has been given to a group of unelected and unrepresentative trustees.”).

39. See generally NORTON, *supra* note 17, at 43–44.

40. See, e.g., HOLCOMBE, *supra* note 25, at 2 (“The primary problem from a public policy standpoint is that foundation trustees have a tremendous amount of wealth at their disposal that they can spend as they see fit. While they are charged with acting in the public interest, they are accountable to nobody.”).

disbursements of funds—which can include loans, in-kind donations, and program-related investments—given to public charities; i.e., entities registered under section 501(c)(3) of the U.S. Tax Code with a verified charitable purpose.<sup>41</sup> Though it would be easy to think of grants as gifts, grants are, in fact, contracts: grantors make grants for particular purposes and do not tend to expect the funds ever to be returned.<sup>42</sup>

Overall, grants fall into two legal categories: general support and project support. In broad strokes, there are fewer restrictions and requirements tied to general support grants than project support grants, though the restrictions provided in a grant agreement can vary in depth for both types of grants.<sup>43</sup> Put simply, the amount of autonomy a grantee has to determine how to spend grant funds is inversely proportional to the amount of specificity or restrictions that the grantor provides in the grant agreement. The following sections will explore the particular nature of both of these types of grants.

### 1. *Project Support Grants*

Project support grants provide funds for specific, pre-determined projects or areas of work that have a timeline, budget, and discrete objectives.<sup>44</sup> When a foundation is considering providing a project support grant to an organization, it solicits both narrative and financial proposals that outline the specifics for the work to be funded.<sup>45</sup> The financial proposal must be tied to the proposed activities, and must exclude certain prohibited expenditures (e.g., lobbying activities, the purchase of capital equipment over a *de minimis* amount, or the funding of grants to individuals).<sup>46</sup> In order

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41. See 26 I.R.C. § 4945 (2014); 26 I.R.C. § 501(c)(3) (2018); FRANCES HILL & DOUGLAS MANCINO, *TAXATION OF EXEMPT ORGANIZATIONS* 11-79 (2002-2009).

42. See, e.g., *Grants Management 101*, ROCKY MOUNTAIN PUBLIC HEALTH TRAINING CENTER (2015), <http://www.grantsmanagement101.org/management-basics.html> [<https://perma.cc/BL9N-EEX9>].

43. See generally *Program Grants vs. Operating Support*, AMPLIFIER, [http://www.amplifiorgiving.org/media/resources/Program\\_Grants\\_vs.\\_General\\_Operating\\_Support\\_including\\_8\\_Tips\\_for\\_Being\\_a\\_Good\\_Donor.pdf](http://www.amplifiorgiving.org/media/resources/Program_Grants_vs._General_Operating_Support_including_8_Tips_for_Being_a_Good_Donor.pdf) [<https://perma.cc/6QQA-9CCR>].

44. See, e.g., *id.*

45. See, e.g., *id.*

46. See 26 I.R.C. § 501(c)(3) (2018). Given the tax-exempt nature of foundation funds, the IRS has an established interest in how those funds are expended. In the 1960s, the misuse of certain foundation funds to both engage in political activities (specifically, the election of the first black mayor in Cleveland, Ohio) and to pay individuals (several Kennedy staffers were given payments to ease their transition out of the administration following the President's death) prompted skepticism, and the

to show that funds were expended for acceptable purposes and in the spirit of what was outlined in the original proposal, project support grants require both narrative and financial reporting at their close, with an option for interim reporting throughout the grant term.<sup>47</sup>

Project support grants are the more restrictive of the two types of grants,<sup>48</sup> allowing donors to fund only those projects they are specifically interested in and, if they choose, to play a role in shaping those projects—both during the proposal and project implementation stages. Funders do tend to remain significantly involved in the efforts they fund through project support grants, approving line-item shifts in the budget and providing advice on project approach and implementation.<sup>49</sup> As project support grants allow funders to remain involved in how grant funds are expended, they are the more popular type of grant.<sup>50</sup> In addition, though most grants are made to 501(c)(3) organizations, it is generally understood that project support grants can be made to organizations other than 501(c)(3) entities, because the specificity with which the grants are made allows funders to ensure that the activities the grant is supporting are in furtherance of a charitable purpose.<sup>51</sup>

## 2. General Support Grants

General support grants, in contrast to project support grants, provide a grantee with unrestricted funds that the grantee can determine how to expend.<sup>52</sup> In other words, general support grant funds are not tied to particular projects, outcomes, or timelines dictated by the funder; instead, grantees can make determinations about how they can best utilize their funds, be it for an existing body of work, to develop a new body of work, to cover overhead costs, to support internal capacity-building efforts, or even to adjust the way

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eventual passage of the Tax Reform Act of 1969. HOLCOMBE, *supra* note 25, at 92, 94–96; H.R. Rep. No. 91-413 (1969); John R. Labovitz, *The Impact of Private Foundation Provisions of the Tax Reform Act of 1969*, 3 J. LEG. STUD. 63, 67 (1974).

47. See U.S. DEP'T TREASURY, I.R.S. Pub. No. 1771 (Rev. 3-2016), <https://www.irs.gov/pub/irs-pdf/p1771.pdf> [<https://perma.cc/9GRJ-3JDK>].

48. See *Program Grants vs. Operating Support*, *supra* note 43.

49. See *id.*

50. See generally *id.*

51. See *infra* Section I.C.

52. See *What Is General Operating Support and Why Is It Important?*, GRANTMAKERS FOR EFFECTIVE ORGANIZATIONS (May 29, 2014), <https://www.geofunders.org/resources/what-is-general-operating-support-and-why-is-it-important-678> [<https://perma.cc/A275-UPVL>].

funds are allocated mid-course in order to remain as responsive and effective as possible.<sup>53</sup>

General support grants can be more legally complicated than project grants. The same legal restrictions apply to general support grants as apply to project support grants—e.g., as noted above, foundations are not allowed to conduct nor support any lobbying or political activities—yet 501(c)(3) public charities are allowed to conduct or participate in a *de minimis* amount of those activities.<sup>54</sup> Logically, this presents a challenge for a foundation that wishes to provide a general support grant to a 501(c)(3) organization that conducts a *de minimis* amount of lobbying or political activity: Though the general support grant is supposed to provide the grantee with full flexibility to determine how the funds are expended, the foundation's funds cannot technically support the grantee's *de minimis* lobbying or political activities. The IRS has responded to this potential challenge by creating a general support safe harbor that allows a foundation to provide a general support grant to a 501(c)(3) organization that conducts a *de minimis* amount of lobbying or political activity, provided the foundation remains completely hands-off and does not earmark (or denote) funds for any particular purpose.<sup>55</sup> If the foundation does require funds to be expended on particular projects or activities, they will lose the protection of the general support safe harbor; in that case, if the grantee ends up using those funds on lobbying in pursuit of those earmarked projects or activities, the foundation will face excise taxes and other potential penalties.<sup>56</sup> In the alternative, if the foundation stays true to the notion of giving the grantee autonomy about how funds are spent, the IRS is willing to accept that money is fungible and will not punish the foundation for having supported an organization that conducts a *de minimis* amount of those otherwise prohibited activities.<sup>57</sup> Therefore, in order to retain the legal safety of the safe harbor when making a general support grant, it is crucial that a foundation avoid both the

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53. See, e.g., *General Operating Support (or Unrestricted) Grants*, *supra* note 12 (discussing how general support allows grantees to “invest” in themselves by building capacity or investing in new areas of work); *Unrestricted Core Support: Strengthening the Capacity of Our Nonprofit Sector*, *supra* note 12; *The Beauty of the General Support Grant*, *supra* note 10.

54. See Allocation of Costs to Lobbying Activities, 26 C.F.R. § 1.162-28(g) (1995).

55. See IRM 7.27.19.3.9 (Feb. 22, 1999).

56. See *id.*; see also Grants to Organizations, 26 C.F.R. § 53.4945-5 (2015).

57. See IRM 7.27.19.3.9 (Feb. 22, 1999); Grants to Organizations, 26 C.F.R. § 53.4945-5 (2015).

action and appearance of earmarking—or denoting—funds for particular purposes.

There are three main ways that foundations approach general support grant making in order to stay within the confines of this general support safe harbor and, as a result, adhere to the intention of providing grantees with greater agency through the use of a general support grant. The simplest way is to take a “blank check” approach.<sup>58</sup> Through this approach, the foundation provides a grant without requiring a proposal or any follow-up reporting.<sup>59</sup> With such sparse requirements, it is hard to generate the perception that the foundation is earmarking funds for any particular purpose.<sup>60</sup> However, this approach is also quite limiting: without insight into the work of a grantee organization, the grant maker has very little knowledge about the organization’s role in the field or how the foundation’s contribution aided its efforts.<sup>61</sup> In addition, the foundation loses key insights into the field of interest. Therefore, many funders prefer to have some higher level of engagement than this.<sup>62</sup>

Even while staying within the confines of the general support safe harbor, the donor *can* have some basic conversations about the organization’s overall goals to ensure sufficient strategic alignment before providing funding.<sup>63</sup> Therefore, a second approach to general support grant making can involve a proposal. Rather than focusing on the project-level detail, however, the focus is on the overall organizational strategy and objectives.<sup>64</sup> Often, a grantee uses its annual strategy document or action plan as the proposal.<sup>65</sup> The foundation might have some conversations with the grantee, but such conversations focus only on the grantee’s organizational strategies and objectives, without indicating any clear preferences for how the grantee spends the funds.<sup>66</sup> The grant agreement in this situation is

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58. Interview with Nicole Campbell, Deputy General Counsel, Open Society Foundations, in New York, N.Y. (Feb. 3, 2016).

59. *Id.*

60. As required by IRM 7.27.19.3.9 (Feb. 22, 1999).

61. Interview with Nicole Campbell, *supra* note 58.

62. *Id.*

63. See generally IRM 7.27.19.3.9 (Feb. 22, 1999); *What Is General Operating Support and Why Is It Important?*, *supra* note 52 (“Despite the unrestricted nature of general operating support, providing it does not mean that grantmakers forfeit the ability to influence how grant dollars are spent or to track the outcomes of their investments.”).

64. Interview with Nicole Campbell, *supra* note 58.

65. *Id.*

66. *Id.*

also sufficiently broad, allowing the grantee to remain in control of how funds are spent and—as long as they remain within the spirit of their original proposal—to shift their work as new circumstances or opportunities arise.<sup>67</sup> With regards to reporting, the grantee can report on any activities that were discussed in the original proposal (the foundation cannot request further information on any one particular project or body of work), and the organization can provide their overall income and expenditures for the year, as long as the foundation's funds are not attributed to particular projects (attribution of the foundation funds to particular activities increases potential possibilities for or appearances of earmarking).<sup>68</sup> Ultimately, this second approach allows the foundation to have an understanding of what the grantee plans to do and what they have actually achieved (which is generally understood to be crucial information for a foundation), while not earmarking their funds for particular purposes.<sup>69</sup> Yet this approach comes with greater risk than the “blank check” approach. By engaging in conversation about grantee activities, the foundation is more at risk of appearing as if they earmarked funds for particular purposes. This appearance of earmarking could become problematic if the grantee uses the funds on prohibited expenditures.

Though the second option does provide a foundation with greater insight into—and opportunity to engage with—the grantee's strategy, there are foundations that desire to have still more engagement in the work of the grantee, even when giving a general support grant. Therefore, there is a third potential approach, often referred to as “negotiated general support.”<sup>70</sup> Through this approach, the foundation has clear conversations with the grantee about what specific projects the foundation wants to see the grantee undertake.<sup>71</sup>

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67. IRM 7.27.19.6.14.1 (Feb. 22, 1999) (“[T]he mere use of grant funds for activities not planned in the original budget is not treated as a diversion. The use of the grant funds must actually be inconsistent with the original purposes of the grant as described in the grant agreement.”).

68. Interview with Nicole Campbell, *supra* note 58.

69. *Id.*

70. See *Bill and Melinda Gates Foundation: General Operating Support (or Unrestricted) Grants*, GRANTCRAFT (Feb. 18, 2015), <http://www.grantcraft.org/casestudies/bill-and-melinda-gates-foundation> [https://perma.cc/D33X-7UNX]; *Unrestricted Core Support: Strengthening the Capacity of Our Nonprofit Sector*, *supra* note 12; *What Is General Operating Support and Why Is It Important?*, *supra* note 52.

71. See *Bill and Melinda Gates Foundation: General Operating Support (or Unrestricted) Grants*, *supra* note 70; *Unrestricted Core Support: Strengthening the*

Though this does mean that the foundation is making its priorities clear to the grantee organization, a foundation may remain within the general support safe harbor by not requiring the grant funds to be spent on any one of the specific projects discussed during these conversations; instead, the grantee retains full control over how the funds are allocated.<sup>72</sup> In other words, a negotiated general support approach de-links the way grant funds are expended from the projects or outcomes that a foundation is interested in a grantee pursuing. Reporting for negotiated general support grants generally must avoid attribution of foundation funds to particular activities, as well, in order to avoid the actual or perceived earmarking of funds for particular activities.<sup>73</sup> Foundations are generally wary of this approach, however, because conversations with a grantee could easily be seen to express specific foundation interests in how they want grant money to be spent.<sup>74</sup>

The challenge with general support grant making is that the grantee's autonomy is inversely proportional to that of the granting foundation.<sup>75</sup> Money is power to a foundation, and by choosing to cede control of how money is spent, the foundation is choosing to cede that influence as well. Given that foundations determine the types of support they provide to grantees, this means that foundations must choose to relinquish a significant amount of control and influence over how the funds are expended, something foundations—with their own theories of change, strategies, and internal accountability structures—naturally hesitate to do.<sup>76</sup> Whether consciously or subconsciously, foundation staff members often feel that they do not have a sufficient level of trust with grantees to fully relinquish decision-making authority.<sup>77</sup> Hurdles include concerns about grantee capacity to manage the funds or implement projects, but also go to foundations' own ego and self-perception.<sup>78</sup> Lastly,

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*Capacity of Our Nonprofit Sector*, *supra* note 12; *What Is General Operating Support and Why Is It Important?*, *supra* note 52.

72. See *Bill and Melinda Gates Foundation: General Operating Support (or Unrestricted) Grants*, *supra* note 70; *Unrestricted Core Support: Strengthening the Capacity of Our Nonprofit Sector*, *supra* note 12; *What Is General Operating Support and Why Is It Important?*, *supra* note 52. See generally IRM 7.27.19.3.9 (Feb. 22, 1999).

73. Interview with Nicole Campbell, *supra* note 58.

74. *Id.*

75. See, e.g., *What Is General Operating Support and Why Is It Important?*, *supra* note 52.

76. Interview with Nicole Campbell, *supra* note 58.

77. *Id.*

78. *Id.*



unless foundations use the “blank check” approach, foundations often perceive that general support grants are more legally risky than project support grants.<sup>79</sup> For all of these reasons, general support grants make up less than one-third of all grants made each year across all foundations.<sup>80</sup>

Despite these concerns, there is an increasingly accepted understanding in the philanthropic community that providing unrestricted funding to grantees is more effective than providing project grants.<sup>81</sup> Given that grantees are generally much closer to and possess greater expertise on their issues of focus than donors, allowing grantees greater control over how grant funds are expended can result in much more effective and responsive programming.<sup>82</sup> The complex fields in which charitable organizations work are constantly evolving and changing: political opportunities appear and disappear, natural disasters occur suddenly, and the complex ecosystem that is civil society and public discourse changes in slight ways that make new approaches or strategies more effective than expected.<sup>83</sup> These constant changes in the environment make it crucial for organizations to be able to adjust their projects in real-time, adapting to the ever-evolving dynamics on the ground. Not only is it more efficient for grantees to be able to make those decisions without having to receive prior approval from the donor, but this approach is also more responsive to the complexities of the real world and can lead to greater impact.<sup>84</sup>

Allowing the grantee to remain in control of how funds are spent also is crucial for avoiding donor-driven agendas. The altruism of donors is complicated, with only the most mature of donors giving for

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79. See *supra* Section I.B.2. (“Yet this approach comes with greater risk than the ‘blank check’ approach. By engaging in conversation about grantee activities, the foundation is more at risk of appearing as if they have earmarked funds for particular purposes. This appearance of earmarking could become problematic if the grantee uses the funds on prohibited expenditures.”).

80. See MCCRAY, *supra* note 10, at 7; see also *infra* Section II.D.

81. E.g., *How Can We Be More Supportive of Nonprofit Financial Sustainability?*, GRANTMAKERS FOR EFFECTIVE ORGANIZATIONS (Mar. 5, 2014), <https://www.geofunders.org/resources/how-can-we-be-more-supportive-of-nonprofit-financial-sustainability-662> [https://perma.cc/C5WH-NVH7]; *The Beauty of the General Support Grant*, *supra* note 10.

82. *How Can We Be More Supportive of Nonprofit Financial Sustainability?*, *supra* note 81; *The Beauty of the General Support Grant*, *supra* note 10.

83. E.g., *The Beauty of the General Support Grant*, *supra* note 10; *Unrestricted Core Support: Strengthening the Capacity of Our Nonprofit Sector*, *supra* note 12.

84. *The Beauty of the General Support Grant*, *supra* note 10; *Unrestricted Core Support: Strengthening the Capacity of Our Nonprofit Sector*, *supra* note 12.

reasons that truly focus on the beneficiary rather than being motivated by more personal motives, such as tax breaks, the desire to be remembered, or from a sense of guilt.<sup>85</sup> Accordingly, most donors have particular ideas about the type of change they want to support or the specific types of projects they want implemented with their money.<sup>86</sup> Unfortunately, due to their distance from the issues, communities, and the nuances involved with the issue at-hand, their interventions often result in misguided attempts at creating change.<sup>87</sup> Some of the most enlightening examples come from the field of international development, though these issues also arise in the civil and political realm.<sup>88</sup>

General support also reduces the likelihood that a grantee will conduct activities solely because the donor desires them.<sup>89</sup> Even when donors are giving for purely altruistic reasons, and would (at least theoretically) avoid the problems described above, grantees—in order to increase their chances of receiving future funding—will often attempt to anticipate what it is donors are looking for.<sup>90</sup> Though this can still occur within the context of a general support grant, it is much less likely to happen when a foundation is having only high-level conversations with an organization, rather than the detailed

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85. Roy Menninger, *Foundation Work May be Hazardous to Your Mental Health: Some Occupational Dangers of Grant Making (and Grant Receiving)* in *GIVING WELL, DOING GOOD: READINGS FOR THOUGHTFUL PHILANTHROPISTS* 129 (Amy A. Kass ed., 1981) (“Reasons for giving come from several sources. They’re not always conscious; one can discern, if one looks carefully, several lower levels of motivation even in the most altruistic acts of giving. The first level is the narcissistic level. A donor gives money for honor and glory — for the name on the building . . . The second level of giving is moralistic and conscience driven, with guilt as the motivation . . . The third level — which might be described as the most mature form of giving — is [focused on] the other, the recipient; not the self, the giver . . . [G]iving is never pure. The most altruistic and most noble giving also contains elements of narcissism and guilt . . .”).

86. See, e.g., Michael Hobbes, *Stop Trying to Save the World*, *NEW REPUBLIC* (Nov. 17, 2014), <https://newrepublic.com/article/120178/problem-international-development-and-plan-fix-it> [<https://perma.cc/U5TR-TP5V>].

87. *Id.*

88. *Id.*

89. See *Unrestricted Core Support: Strengthening the Capacity of Our Nonprofit Sector*, *supra* note 12 (“If our goal is to help organizations become stronger and, therefore, more effective, we need nonprofits to tell us what they need — not what they think we want to hear. And then we must have the willingness to be responsive and provide the flexible and long-term funding needed to build strong organizations and deliver effective programs.”).

90. *Id.*

conversations that can occur within the context of a project support grant.<sup>91</sup>

Lastly, general support grants help organizations to develop.<sup>92</sup> When an organization receives fully restricted funding, they are not able to move funds around as new situations arise or new needs develop.<sup>93</sup> Though an organization might have enough funding to cover their projects and (ideally) the associated core costs, they may not have funds to, for example, purchase new financial software, send their staff to relevant training, fund a search committee for a pending leadership transition, or even have the flexibility to undertake a new project if a window of unforeseen opportunity arises.<sup>94</sup> With a general support grant, the grantee organization has that helpful flexibility, and is able to use the funds the way they need to use them the most.<sup>95</sup> This bolsters the ability of the organization's leadership to respond appropriately to the organization's most pressing needs.<sup>96</sup>

### C. Grant Making to International Organizations: The Expenditure Responsibility Requirements

As described above, foundations are allowed to use their tax-exempt funds to provide either project support or general support to organizations defined as charitable by section 501(c)(3) of the U.S. Tax Code.<sup>97</sup> However, there are many organizations that fall outside of this categorization, including certain domestic organizations—such as neighborhood organizations, public hospitals, and housing developments—as well as the majority of foreign-based

91. *Id.*

92. *E.g.*, *How Can We Be More Supportive of Nonprofit Financial Sustainability?*, *supra* note 81; *How Do We Know if a Grantee Is a Good Candidate for General Operating Support?*, GRANTMAKERS FOR EFFECTIVE ORGANIZATIONS (July 15, 2014), <https://www.geofunders.org/resources/how-do-we-know-if-a-grantee-is-a-good-candidate-for-general-operating-support-652> [<https://perma.cc/9N72-XXV5>]; *Support Nonprofit Resilience*, GRANTMAKERS FOR EFFECTIVE ORGANIZATIONS, <http://www.geofunders.org/smarter-grantmaking/nonprofit-resilience/financial-sustainability> [<https://perma.cc/8VYV-B7WE>]; Anna Pond, *Supporting Grantee Capacity: Strengthening Effectiveness Together*, GRANTCRAFT (2015), at 6, [http://www.grantcraft.org/assets/content/resources/guide\\_capacity\\_interactive.pdf](http://www.grantcraft.org/assets/content/resources/guide_capacity_interactive.pdf) [<https://perma.cc/WC2Z-CWPR>]; *What Is General Operating Support and Why Is It Important?*, *supra* note 52.

93. *What Is General Operating Support and Why Is It Important?*, *supra* note 52.

94. *Id.*

95. *Id.* at 3–4.

96. *Id.*

97. Taxes on Taxable Expenditures, 26 U.S.C. § 4945 (2014).

organizations.<sup>98</sup> The IRS *does* make it possible to fund the charitable activities of these organizations with tax-exempt dollars, but alternative regulations govern and change the nature of the types of grants (e.g., project support or general support) that a foundation can provide.<sup>99</sup>

In fact, there are two procedures through which foundations can approach grant making in this context: equivalency determination or expenditure responsibility. Equivalency determination is the process through which a foundation deems an organization to be the equivalent of a 501(c)(3).<sup>100</sup> Expenditure responsibility is the process through which a foundation ensures that grant funds are spent on only those activities that a 501(c)(3) organization can conduct.<sup>101</sup> Though there are benefits and detriments to both approaches, both options serve to assure the IRS that tax-exempt foundation dollars are being used to support charitable activities only.

First, through an equivalency determination, a foundation or qualified external tax expert determines<sup>102</sup> that a foreign organization is the equivalent of a U.S. 501(c)(3) organization.<sup>103</sup> An organization

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98. Taxes on Taxable Expenditures, 26 U.S.C. § 4945 (2014); *see also* Charitable, etc. Contributions and Gifts, 26 U.S.C. § 170 (2017).

99. Taxes on Taxable Expenditures, 26 U.S.C. § 4945 (2014); Grants to Organizations, 26 C.F.R. § 53.4945-5(a)(1) (2015).

100. “Equivalency determination (ED) is a process by which a U.S. grantmaker evaluates whether an intended foreign grantee is the equivalent of a U.S. public charity. The grant maker must collect a set of detailed information about the grantee’s operations and finances and make a reasonable determination of its equivalency.” *See What Is Equivalency Determination*, NGO SOURCE, <http://www.ngosource.org/how-it-works/what-is-equivalency-determination> [<https://perma.cc/VL26-ABWH>].

101. Taxes on Taxable Expenditures, 26 U.S.C. § 4945 (2014); Grants to Organizations, 26 C.F.R. § 53.4945-5(a)(1) (2015); IRM. 7.27.19 (Feb. 22, 1999).

102. Foundations can make this determination themselves, on the advice of counsel. The rigidity of the requirements makes foundations confident in their determinations. Alternatively, foundations can use an outside provider to make equivalency determinations, such as NGO Source. *See* NGO SOURCE, <http://www.ngosource.org/> [<https://perma.cc/P77F-CQMU>].

103. Rev. Proc. 92-94, 1992-2 CB 507 (superseded by Rev. Proc. 2017-53); *see What Is Equivalency Determination*, *supra* note 100; *see also* Betsy Adler & Stephanie Petit, *Equivalency or Expenditure Responsibility? A Guide in Plain English*, 73 INTERNATIONAL DATELINE (2005), <https://www.adlercolvin.com/wp-content/uploads/2017/12/Legal-Dimension-Equivalency-or-Expenditure-Responsibility-00069171xA3536.pdf> [<https://perma.cc/ZWZ4-2WSP>]; *see generally* Stephanie L. Petit, *IRS Releases Revenue Procedure 2017-53 on Foreign Public Charity Equivalency Determinations*, ADLER & COLVIN BLOG (Sept. 15, 2017), <https://www.adlercolvin.com/blog/2017/09/15/irs-releases-revenue-procedure-2017-53-on-foreign-public-charity-equivalence-determinations/> [PERMA] (explaining that Rev. Proc. 2017 modifies and supersedes Rev. Proc. 92-94, 1992-2 CB 507).

can be deemed the equivalent of a U.S. 501(c)(3) if it meets a series of tests that align with the 501(c)(3) requirements, including having a diversity of funding sources, meeting minimum distribution requirements, adhering to regulations on self-dealing, and conducting charitable activities.<sup>104</sup> Once a foundation considers the organization to be an equivalent, an organization can be treated just as any other 501(c)(3) organization and can receive both project support and general support grants with tax-exempt funds.<sup>105</sup> This makes grant making quite easy; therefore, equivalency determination is generally considered more favorable than expenditure responsibility.<sup>106</sup> Despite this favorability, however, many organizations cannot achieve equivalency determination.<sup>107</sup> Equivalency determination is difficult to achieve for a variety of reasons, including language barriers, paperwork/accounting requirements, the time that the process takes, or the variety of sources from which an organization receives its funding.<sup>108</sup> When equivalency determination is not possible, foundations must turn to expenditure responsibility in order to make grants using their tax-exempt funds.

Expenditure responsibility is the second alternative for how a foundation can provide funding to an organization that is not a 501(c)(3) public charity (or equivalent), yet still retain the tax-exempt status for the grant funds.<sup>109</sup> Like equivalency determination, the purpose of expenditure responsibility is to ensure that U.S. money being donated abroad (or to any other organization that is not registered as charitable) is used for approved, exempt purposes.<sup>110</sup> However, rather than focusing on the overall nature of the organization as a whole—as equivalency determination does—

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104. Rev. Proc. 92-94, 1992-2 CB 507 (superseded by Rev. Proc. 2017-53). See *What Is Equivalency Determination*, *supra* note 100; see also Adler & Petit, *supra* note 103.

105. Rev. Proc. 92-94, 1992-2 CB 507 (superseded by Rev. Proc. 2017-53). See *What Is Equivalency Determination*, *supra* note 100; see also Adler & Petit, *supra* note 103.

106. See *supra* Section I.C.

107. See generally BLAZEK, *supra* note 17, at 485 (“[S]eeking the appropriate information described in the preceding subsection from a foreign organization is not so simple and is often troublesome due to language, currency, and legal differences. Because of these difficulties, a private foundation will sometimes find it more comfortable to treat such foreign grantees as expenditure responsibility grants to avoid unexpected results.”).

108. *Id.*

109. Taxes on Taxable Expenditures, 26 U.S.C. § 4945 (2014); Grants to Organizations, 26 C.F.R. § 53.4945-5(a)(1) (2015); IRM 7.27.19 (Feb. 22, 1999).

110. Taxes on Taxable Expenditures, 26 U.S.C. § 4945 (2014); Grants to Organizations, 26 C.F.R. § 53.4945-5(b)(1) (2015).

expenditure responsibility looks to the charitable nature of the specific activities that are being funded with exempt dollars.<sup>111</sup>

The expenditure responsibility requirements are laid out in 26 U.S.C. § 4945.<sup>112</sup> In order to satisfy the expenditure responsibility requirements, foundations must adhere to a variety of rules that govern how they can make each expenditure responsibility grant to help ensure that grant funds will be used for charitable activities only. The generally accepted legal interpretation of the statute provides that a foundation must:<sup>113</sup>

1. Conduct a **pre-grant inquiry** to ensure that a grantee organization is capable of adhering to the expenditure responsibility restrictions on grant funds;<sup>114</sup>
2. Require a **written grant proposal and written grant agreement** that documents permissible and restricted uses for grant funds;<sup>115</sup>
3. Meet a series of **reporting requirements** to document proper use of grant funds;<sup>116</sup> and
4. **Disclose grant information** annually to the IRS through the foundation's tax filings.<sup>117</sup>
5. If the grantee fails to adhere to the expenditure responsibility requirements, the foundation must **take action to remedy the misuse of funds**.<sup>118</sup>

In sum, these requirements are generally interpreted to be quite arduous and require a high level of specificity from the grantee, both

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111. *General Explanation of the Tax Reform Act of 1969*, BLUEBOOK 3; SANDERS, *supra* note 22, at 102.

112. See Appendix A for the full statute.

113. *E.g.*, *Expenditure Responsibility Rules for Private Foundations*, LEARN FOUNDATION LAW, <http://learnfoundationlaw.org/transcript/expenditure-responsibility-rules-for-private-foundations-course-transcript/> [https://perma.cc/L6XA-5Q3Z]; *see also* HILL & MANCINO, *supra* note 41, at 11-80 to 11-89; Robert Wexler, *Expenditure Responsibility—A Primer and Ten Puzzling Problems*, ADLER & COLVIN (Sept. 2010), <https://www.adlercolvin.com/wp-content/themes/adlercolvin/pdf/Expenditure-Responsibility-A-Primer-and-Ten-Puzzling-Problems.pdf> [https://perma.cc/T8NM-LZV5].

114. *See* Wexler, *supra* note 113; *see also* Grants to Organizations, 26 C.F.R. § 53.4945-5(b)(2) (2015).

115. *See* Wexler, *supra* note 113; *see also* Grants to Organizations, 26 C.F.R. § 53.4945-5(b)(3) (2015).

116. *See* Wexler, *supra* note 113; *see also* Grants to Organizations, 26 C.F.R. § 53.4945-5(c) (2015).

117. *See* Wexler, *supra* note 113; *see also* Grants to Organizations, 26 C.F.R. § 53.4945-5(d) (2015).

118. *See* Wexler, *supra* note 113; *see also* Grants to Organizations, 26 C.F.R. § 53.4945-5(e) (2015); HILL & MANCINO, *supra* note 41, at 11-90; *Expenditure Responsibility Rules for Private Foundations*, *supra* note 113.

of which require time and capacity.<sup>119</sup> The next few paragraphs will explore each of these five requirements in greater depth.

### 1. *Pre-Grant Inquiry*

A pre-grant inquiry (“PGI”) is required under expenditure responsibility in order to ensure that the recipient organization is—to the best of the foundation’s judgment—able to adhere to the terms of the grant agreement. This determination is based upon a reasonable person standard; in other words, the depth of a PGI must be what a reasonable person would consider appropriate given the circumstances.<sup>120</sup> Some factors that can be considered to determine what is reasonable include the size of the grantee organization, the size of the grant, the type of activities in which they are involved, the length of time that the foundation has known the organization, and the amount of experience of the organization in managing expenditure responsibility grants in the past.<sup>121</sup> Though, in some cases, past experience of the grantee organization can alone be considered sufficient to fulfill the PGI requirements without any further inquiry, most foundations conduct their own PGIs for each expenditure responsibility grant.<sup>122</sup> An expenditure responsibility grant *can* be made to a new organization, as long as foundation leadership is sufficiently confident, based on the PGI, that the grantee organization is capable of managing—and will comply with—the expenditure responsibility requirements.<sup>123</sup>

### 2. *Written Grant Proposal and Written Grant Agreement*

A second requirement under expenditure responsibility is that of written grant proposals and agreements.<sup>124</sup> The written proposal submitted by the grantee to the foundation must include the purpose

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119. *E.g.*, Donald Vacin, *Guidelines for Foundation Administration Under the Tax Reform Act*, 52 TAXES 277, 293 (1974) (“[T]he requirements for exercising expenditure responsibility are onerous, and failure to meet them can subject the Foundation and its managers to the section 4945 penalties.”).

120. *See* Grants to Organizations, 26 C.F.R. § 53.4945-5(b)(2) (2015) (observing that the PGI will “vary from case to case depending upon the size and purpose of the grant,” as well as the grant term and the organization’s prior experience with expenditure responsibility requirements); HILL & MANCINO, *supra* note 41, at 11-82 (noting that the PGI “should be complete enough to meet the reasonable-person standard that the grant will be used for the proper purposes”).

121. *E.g.*, HILL & MANCINO, *supra* note 41, at 11-82.

122. *See id.*

123. *See id.* at 11-83.

124. *See* Grants to Organizations, 26 C.F.R. § 53.4945-5(b)(3) (2015).

of the grant; the promise to repay unspent funds; and a commitment to submit annual reports, record expenditures, and to use funds only for acceptable, charitable purposes.<sup>125</sup> An expenditure responsibility grant cannot be used to cover the expenses for certain prohibited activities, including lobbying, capital equipment purchases,<sup>126</sup> or grants to individuals<sup>127</sup>; therefore, if the organization proposes to conduct prohibited activities, the proposal must also specify how those activities are being funded by sources other than the expenditure responsibility grant.<sup>128</sup> Ultimately, the proposal can then serve as the basis for what must be a signed grant agreement between the grantee organization and the foundation.

### 3. Reporting Requirements

Expenditure responsibility also requires the grantee to write a financial and narrative report at the end of every grant term.<sup>129</sup> The narrative report must explain how grant funds were applied towards specific projects or efforts, in a manner sufficient to confirm that funds were not spent on any prohibited expenditures.<sup>130</sup> In addition, the narrative report must describe how the organization made progress towards the objectives outlined in the original proposal; though it is acceptable if the final activities do not align exactly with the initial proposal, the activities conducted must remain in alignment with the spirit of the original proposal and not attribute the funding of

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125. *E.g.*, HILL & MANCINO, *supra* note 41, at 11-83 to 11-84.

126. In truth, this is actually a little more complicated. Capital equipment can actually be purchased with funds from an ER grant, as long as the equipment is used for approved purposes (*e.g.*, non-lobbying activities). In order to ensure that the equipment is being used in the appropriate manner, grantees must report on the equipment for at least two years, and perhaps longer if it is unclear whether the equipment might be used to help further lobbying activities in the future. Given this reporting requirement, most foundations choose not to fund any capital purchases above a *de minimis* threshold with funds that come with ER restrictions. *See* Grants to Organizations, 26 C.F.R. § 53.4945-5(c)(2) (2015).

127. *See* Taxes on Taxable Expenditures, 26 U.S.C. § 4945 (2014); Grants to Organizations, 26 C.F.R. § 53.4945-5(e) (2015).

128. *See* 26 C.F.R. Sxn 53.4945 (b)(3)(iv).

129. *See* Grants to Organizations, 26 C.F.R. § 53.4945-5(c)(1) (2015).

130. *See* HILL & MANCINO, *supra* note 41, at 11-86 (“[T]he regulations generally require that the reports show the use of the funds, compliance with the terms of the grant, and the progress made by the grantee toward achieving the purposes for which the grant was made.”). Referring back to a more detailed description of a project provided in a proposal can be sufficient, as long as implementation mirrored the proposal. *Id.*



any prohibited activities to the expenditure responsibility grant.<sup>131</sup> Similarly, the financial reports must outline how grant funds were spent as a way to ensure that no funds were used for lobbying or other prohibited expenditures, as demonstrated in the sample report in Appendix B.<sup>132</sup> A financial report must be submitted at the end of any fiscal period in which a grantee receives expenditure responsibility funds from a foundation.<sup>133</sup> Therefore, if a grant spans multiple fiscal years, the grantee organization must submit a financial report at the end of each fiscal year, as well as at the end of the project when the grantee has expended all funds.<sup>134</sup> The foundation can request or mandate further narrative and/or financial reporting if included in the signed grant agreement.<sup>135</sup> If grant funds remain following the completion of the agreed-upon grant activities, the grantee organization must continue to submit reports either until all funds are expended or any funds remaining are returned, as a way to confirm that funds were expended for acceptable purposes only.<sup>136</sup>

#### 4. Disclosure of Grant Information

The final expenditure responsibility requirements cover mandatory disclosure to the IRS.<sup>137</sup> As with all grants, foundations are obligated to disclose to the IRS any expenditure responsibility grants they make each year in their annual tax filings; in addition, a foundation must have all related documentation on-file, ready to be accessed in case of audit.<sup>138</sup> The IRS tends to interpret this requirement strictly.<sup>139</sup>

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131. See HILL & MANCINO, *supra* note 41, at 11-90 (“[A] diversion of grant funds involves more than merely using the funds for a purpose different from that indicated in the grant’s original budget projection; the use must actually be inconsistent with the original purposes of the grant as described in the grant agreement.”).

132. See Grants to Organizations, 26 C.F.R. § 53.4945-5(c)(1) (2015). See Appendix B for a sample financial report.

133. See HILL & MANCINO, *supra* note 41, at 11-86.

134. See *id.*

135. 26 C.F.R. Sxn 53.4945 (c)(1); Adler & Petit, *supra* note 103.

136. See Grants to Organizations, 26 C.F.R. § 53.4945-5(c)(1) (2015).

137. See Grants to Organizations, 26 C.F.R. § 53.4945-5(d)(1) (2015).

138. See Grants to Organizations, 26 C.F.R. § 53.4945-5(d)(3) (2015); see also HILL & MANCINO, *supra* note 41, at 11-87, 11-89.

139. *E.g.*, HILL & MANCINO, *supra* note 41, at 11-88 to 11-89 (explaining that even corrected tax returns sometimes are not considered sufficient to be in compliance with the expenditure responsibility disclosure requirements).

### 5. Taking Action to Remedy the Misuse of Funds

If a foundation fails to adhere to the expenditure responsibility standards, there are a series of potential penalties with varying levels of severity. Generally, any grant for which the foundation does not meet the requirements will be treated as a taxable expenditure.<sup>140</sup> Excise taxes will then be charged to the foundation managers, as a way of increasing individual accountability.<sup>141</sup> If the failure to comply with expenditure responsibility requirements continues significantly over time, the IRS can revoke a foundation's tax-exempt status.<sup>142</sup>

Despite this responsibility, the provision of an expenditure responsibility grant does not mean that a foundation becomes responsible for the grantee's every action.<sup>143</sup> It is the expectation that a foundation will exercise its judgment about when it is or is not appropriate to make an expenditure responsibility grant, conduct an appropriate level of due diligence, and make its best effort to ensure compliance with the relevant code and regulations. As long as the foundation made a reasonable determination that the grantee would adhere to the expenditure responsibility requirements, a foundation is not the "insurer of the activity of the organization to which it makes a grant."<sup>144</sup> A foundation is allowed to accept statements made in reports as true, unless it has reason to doubt their authenticity.<sup>145</sup> If the grantee fails to live up to all of the requirements—such as failing to submit a required report or failing to return funds spent for unacceptable purposes under the expenditure responsibility framework—the foundation will not be penalized as long as the

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140. See Taxes on Taxable Expenditures, 26 U.S.C. § 4945 (2014); Grants to Organizations, 26 C.F.R. § 53.4945-5(e) (2015).

141. See Taxes on Taxable Expenditures, 26 U.S.C. § 4945 (2014).

142. See *How to Lose Your Tax Exempt Status (Without Really Trying)*, IRS, <https://www.irs.gov/pub/irs-tege/How%20to%20Lose%20Your%20Tax%20Exempt%20Status.pdf> [<https://perma.cc/3NCS-SRXM>].

143. See Grants to Organizations, 26 C.F.R. § 53.4945-5(b)(1) (2015) (clarifying that foundations are not "an insurer of the activity of the organization to which it makes a grant"); S. Rep. No. 91-552, at 2078 (1969) (noting that expenditure responsibility does not make a "granting foundation an insurer of the activity of the organization to which it makes a grant, so long as it uses reasonable efforts and establishes adequate procedures so that the funds will be used for proper charitable purposes").

144. See Grants to Organizations, 26 C.F.R. § 53.4945-5(b)(1) (2015); S. Rep. No. 91-552, at 2078 (1969).

145. See HILL & MANCINO, *supra* note 41, at 11-87 ("[T]he grantor private Foundation generally may rely on the reports submitted by a grantee and is not required to conduct any independent verification of the grantees reports unless it has reason to doubt their accuracy or reliability.").

foundation itself takes “reasonable and appropriate” remedial steps, such as disclosing the grant to the IRS and withholding any future payments or grants to the organization until they have come fully into compliance with the expenditure responsibility requirements.<sup>146</sup>

The expenditure responsibility requirements generally are interpreted to be arduous and present risk, for either general or project support grants.<sup>147</sup> Given the potential negative impact that failing to adhere to the expenditure responsibility requirements can create for a foundation, foundation managers and counsel tend to interpret the requirements strictly, in a risk-averse manner, in order to ensure compliance with the law, thereby avoiding potential sanctions or loss of tax-exempt status.<sup>148</sup> As a result, these codes and regulations affect foundation behavior by creating a number of disincentives that were not necessarily the intent of the law and related regulations; this includes an increased reliance on lawyers, given the complexity of the law and the associated risks, and a general avoidance of funding non-501(c)(3) organizations, small grants, or new organizations altogether.<sup>149</sup> This interpretation of the limitations and burdens of the expenditure responsibility requirements is further explored and dissected in the coming sections.

## II. FOUNDATION RELUCTANCE TO MAKE GENERAL SUPPORT GRANTS WHILE OPERATING UNDER EXPENDITURE RESPONSIBILITY REQUIREMENTS

The regulations governing expenditure responsibility expressly state that it is possible to make a general support grant within the confines of expenditure responsibility,<sup>150</sup> yet legal interpretation and foundation practice consistently emphasize the use of project grants alone when working under the expenditure responsibility requirements.<sup>151</sup> Section II.A reviews the governing portion of the

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146. *See id.* But see SUBCOMMITTEE ON OVERSIGHT OF THE COMMITTEE ON WAYS AND MEANS, 98th Cong., DEVELOPMENT OF THE LAW AND CONTINUING LEGAL ISSUES IN THE TAX TREATMENT OF PRIVATE FOUNDATIONS 32 (Comm. Print 1983) (specifying that expenditure responsibility “requires grant-making foundations to assume the responsibility that their grantees will use their grants properly”); Labovitz, *supra* note 46, at 83.

147. *See infra* Section II.B.

148. *See* Grants to Organizations, 26 C.F.R. § 53.4945-5(e) (2015).

149. *E.g.*, Labovitz, *supra* note 46, at 82; SANDERS, *supra* note 22, at 1268.

150. *See* Grants to Organizations, 26 C.F.R. § 53.4945-5(b)(3) (2015).

151. *E.g.*, *Expenditure Responsibility Rules for Private Foundations*, *supra* note 113.

U.S. Tax Code,<sup>152</sup> the C.F.R.,<sup>153</sup> the I.R.M.,<sup>154</sup> and the related legislative history, to explain the ways in which general support grants seem to be an acceptable option under the expenditure responsibility requirements. Section II.B explores foundation practice as it relates to expenditure responsibility implementation, and then Section II.C reviews the policy debate about whether the use of general support should or should not increase.

**A. The United States Code, Code of Federal Regulations, and the Internal Revenue Manual: The Explicit Mention of “General Support”**

Section 4945 of United States Code Title 26 addresses expenditure responsibility.<sup>155</sup> Its language is fairly general and sufficiently vague, framing expenditure responsibility as a positive exception to the rules governing the taxation of foundation expenditures to non-exempt organizations.<sup>156</sup> The only requirements are that a foundation is obligated “(1) to see that the grant is spent solely for the purpose for which [it is] made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Secretary.”<sup>157</sup> There is no mention of the types of grants that foundations can or cannot make while maintaining compliance with these requirements; in other words, while this portion of the Code does not state affirmatively that general support grants are allowed, neither does it state that general support grants are prohibited.

A more nuanced and interesting picture of what expenditure responsibility actually means only begins to form when examining the relevant portion of the C.F.R.: 26 C.F.R. § 53.4945-5. Where the U.S. Code remains vague, the C.F.R. begins to provide more specifics. For example, it is in this part of the Code that many of the specific

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152. See 26 U.S.C. §§ 4940–4948 (2014).

153. See *generally* Purposes 1 C.F.R. § 301.2 (2010).

154. A reference guide for tax authorities. See *generally* IRM 1.1.1.1 (June 2, 2015).

155. Expenditure responsibility was first introduced in The Tax Reform Act of 1969, a law that perhaps “has done more to influence modern philanthropy” than any other law before or since. See Peter Frumkin, *The Ironies of Foundation Regulation*, CHRON. PHILANTHROPY (Feb. 5, 2004), [https://www.philanthropy.com/article/The-Ironies-of-Foundation/164851?cid=cprd\\_home](https://www.philanthropy.com/article/The-Ironies-of-Foundation/164851?cid=cprd_home) [<https://perma.cc/UPW3-5FPH>]. See also HOLCOMBE, *supra* note 25, at 1 (“[T]he 1969 tax reform was the biggest public policy change ever undertaken with regard to America’s nonprofit Foundations.”).

156. See 26 U.S.C. § 4945 (2014).

157. *Id.* § 4945(h)(1)-(3).

expenditure responsibility requirements are first introduced, such as the requirements for a pre-grant inquiry, written and signed grant agreement, and to repay any unused or misused funds; in addition, this section of the C.F.R. further elaborates on the reporting requirements.<sup>158</sup>

Most importantly, general support is explicitly mentioned in the C.F.R.: the grant agreement:

must also clearly specify the purposes of the grant. Such purposes may include contributing for capital endowment, for the purchase of capital equipment, or for general support provided that neither the grants nor the income therefrom may be used for purposes other than those described in section 170(c)(2)(B).<sup>159</sup>

Unfortunately, despite this express mention of general support, no further guidance is provided in the C.F.R. about how a foundation might make a general support grant under expenditure responsibility.<sup>160</sup> The same holds true for the I.R.M., in which certain details are further delineated regarding how expenditure responsibility grants might look, yet further guidance is not provided about how general support grants might be made.<sup>161</sup>

The policy purposes behind expenditure responsibility also support the idea that general support is allowed within the confines of expenditure responsibility. The legislative history uncovers that the purpose of expenditure responsibility is to ensure that funds donated to foreign organizations are used to promote the public good, just as funds donated to 501(c)(3) organizations or their equivalents would be limited.<sup>162</sup> As stated in the C.F.R., expenditure responsibility is intended to “impose[] restrictions on the use of the grant substantially equivalent to the limitations imposed on a domestic private foundation under section 4945(d),” but not to go any further.<sup>163</sup> The key is to balance flexibility with responsibility.<sup>164</sup> General support grants are allowed to public charities and their equivalents; therefore,

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158. See 26 C.F.R. § 53.4945-5 (2015).

159. *Id.*

160. See *id.*

161. See IRM7.27.19.3.11, 6.1, 6.7 (Feb. 22, 1999).

162. See H.R. Rep. No. 91-413, at 1648 (1969) (observing that expenditure responsibility intends “to prevent self-dealing between the foundations and their substantial contributors, to require the distribution of income for charitable purposes, to limit their holdings of private businesses, to give assurance that their activities are restricted as provided by the exemption provisions of the tax laws, and to be sure that investments of these organizations are not jeopardized by financial speculation.”).

163. 26 C.F.R. § 53.4945-5(b)(5) (2015).

164. See H.R. Rep. No. 91-413, at 1680 (1969).

in order to maintain this equity and balance, Congress likely intended that they be allowed in the expenditure responsibility context as well.<sup>165</sup>

The way that expenditure responsibility is framed—as an exception to otherwise taxable expenditures—also seems to promote the notion that the requirements should have some associated flexibility.<sup>166</sup> By consequence, expenditure responsibility appears to be an avenue for providing greater breadth and flexibility for foundations in their grant making. The expenditure responsibility requirements also inherently afford a significant level of discretion to foundations.<sup>167</sup> Rather than focusing on what a grantee must do, the expenditure responsibility requirements provide clarity about what a grantee must *not* do.<sup>168</sup> The prohibitions limit lobbying and other political activity, capital equipment purchases and individual grant making; beyond that, grantees are simply required to submit “full and complete” reports and foundations are expected merely to use “reasonable efforts” and “adequate procedures” to ensure compliance.<sup>169</sup> A seemingly low standard of obligation,<sup>170</sup> this leaves latitude for foundations to determine that they have enough trust with grantees and have provided those grantees with sufficient guidance that they can provide general support and still remain confident that the grantee will not use the funds for prohibited expenditures.

Another piece of evidence that supports the notion that Congress did not intend to limit general support within the expenditure responsibility context is that the grantee is not required to adhere strictly to the grant proposal during implementation. As long as the grantee avoids prohibited expenditures, it is well-established that the grantee will be considered in compliance with expenditure responsibility requirements if the purposes for which they expend the grant funds are within the spirit of the original proposal.<sup>171</sup> In other

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165. *See id.*

166. *See* 26 U.S.C. § 4945(d)(4)(B) (2014).

167. *See, e.g.*, 26 C.F.R. § 53.4945-5(b)(1)(i)–(iii) (2015); 26 U.S.C. § 4945 (2014); IRM 7.27.19.6.5 (Feb. 22, 1999).

168. *See, e.g.*, 26 C.F.R. § 53.4945-5(c)–(e) (2015); IRM 7.27.19.6.14.1–14.2 (Feb. 22, 1999).

169. *See* 26 C.F.R. § 53.4945-5(c)–(e) (2015); IRM 7.27.19.6.14.1–14.2 (Feb. 22, 1999).

170. H.R. Conf. Rep. No. 91-782, at 7 (1969), *as reprinted in* 1969 U.S.C.C.A.N. 2391, at 2392 (noting that expenditure responsibility is only supposed to prohibit the narrow circumstance of lobbying on proposed legislation; it is “not intended to prevent the examination of broad social, economic, or similar problems”).

171. *See* IRM 7.27.19.6.14.1. (Feb. 22, 1999).

words, the grantee need not implement exactly the activities as outlined in the original proposal.<sup>172</sup> Specifically, the I.R.M. states:

The diversion of grant funds by a grantee organization to any use not in furtherance of a purpose specified in the grant may result in the diverted portion of the grant being a taxable expenditure under IRC 4945(d)(4). However, the mere use of grant funds for activities not planned in the original budget is not treated as a diversion. The use of the grant funds must actually be inconsistent with the original purposes of the grant as described in the grant agreement.<sup>173</sup>

This implies that a grantee can have some flexibility in their programmatic implementation of an expenditure responsibility grant, as long as they are sure to avoid the short list of prohibited expenditures—a notion aligned with the spirit of general support grant making.

### B. Foundation Practice

Despite the express mention of “general support” in the C.F.R. and I.R.M., expenditure responsibility involves a series of requirements that foundation managers and counsel—who are primarily concerned with protecting a foundation’s tax-exempt status—interpret strictly and, remarkably consistently, not to allow that form of grant making.<sup>174</sup> Under expenditure responsibility, a foundation must be able to ensure that a grantee organization spends grant funds solely on charitable purposes, and does not spend grant funds on lobbying activities, political activities, or for several other forms of inappropriate expenditures.<sup>175</sup> The most natural way to ensure that these requirements are met is to earmark funds for particular purposes and provide very specific, restricted funding—or project grants—to organizations.<sup>176</sup> This earmarking not only contrasts directly with the unrestricted nature and purpose of general support, but conflicts with what is needed to remain within the general support

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172. *See id.*

173. *See id.*

174. Interview with Nicole Campbell, *supra* note 58. *See also generally* Vacin, *supra* note 119; Eric M. Zolt, *Tax Deduction for Charitable Contributions: Domestic Activities, Foreign Activities, or None of the Above*, 63 HASTINGS L.J. 361 (2011); NORTON, *supra* note 17; JONATHAN R. MOORE, A PRACTICAL GUIDE TO INTERNATIONAL PHILANTHROPY 67–68 (2010); BLAZEK, *supra* note 17; JODY BLAZEK & BRUCE R. HOPKINS, PRIVATE FOUNDATIONS: TAX LAW AND COMPLIANCE (2014); Adler & Petit, *supra* note 103; Wexler, *supra* note 113.

175. *See* 26 C.F.R. § 53.4945-5(b)(3)(iv) (2015); 26 U.S.C. § 4945(d)(4) (2014).

176. Interview with Nicole Campbell, *supra* note 58.

safe harbor.<sup>177</sup> Given that failing to adhere to these regulations and guidelines can result in a series of excise taxes at best and loss of tax exemption at worst, it is critical that private foundations stay within the boundaries of the law.<sup>178</sup> Thus, foundation managers and legal counsel advise a safe approach: that only project grants be made under the expenditure responsibility framework.<sup>179</sup>

Furthermore, the requirements outlined in the expenditure responsibility regulations are generally perceived to work against the spirit of relinquishing control and providing flexible funds to grantees through general support. In fact, some foundations interpret these requirements so strictly that many actually avoid making expenditure responsibility grants as institutional policy.<sup>180</sup> Michael Sanders, a leading lawyer on taxation of exempt organizations, suggests in his book *Joint Ventures Involving Tax-Exempt Organizations* that, “[t]o avoid the administrative burden imposed by these special requirements for grants to foreign private foundations, it is recommended that the foundation consider adopting a general policy that grants are to be made solely to public charities or their equivalents.”<sup>181</sup> When expenditure responsibility grants are made, Sanders continues, they require “careful, case-by-case legal review.”<sup>182</sup>

Though this strict interpretation does reduce risk for a foundation, general support grants offer such great value for a wide array of organizations that additional risk may be justified for some foundations.<sup>183</sup> The next section explores the reasons why a more flexible interpretation of the expenditure responsibility requirements is not only possible, but *should* be adopted, even while recognizing the legitimate risk-averse instincts that many foundations and legal practitioners currently exercise.

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177. IRM 7.27.19.3.9 (Feb. 22, 1999).

178. See IRM 7.27.19.2 (Feb. 22, 1999); 26 C.F.R. § 53.4945-5(2)–(3) (2015); see also HILL & MANCINO, *supra* note 41, at 11-81 (“[S]trict compliance with the expenditure responsibility requirements [] is crucial.”).

179. See IRM 7.27.19.2 (Feb. 22, 1999); 26 C.F.R. § 53.4945-5(2)–(3) (2015); see also HILL & MANCINO, *supra* note 41, at 11-81.

180. See SANDERS, *supra* note 22, at 1268–69.

181. *Id.* at 1268.

182. *Id.*

183. Recall the earlier list of domestic organizations—such as neighborhood organizations or hospitals—as well as all foreign organizations who do charitable work but who may not meet the distribution requirements to receive an equivalency determination. See *supra* Section I.C.



**C. The Benefits and Importance of Providing General Support Grants: Why Foundations and the IRS *Should* Interpret Expenditure Responsibility Requirements to Allow General Support Grant Making**

In this next section, this Note provides an overview of the reasons foundations should be increasing their use of general support grants, as well as a review of arguments to the contrary.

*1. General Support Is Better for Organizations, Better for Innovation, and Better for Society*

There is increasing agreement that general support is better for grantee organizations, better for innovation, and ultimately better for the public good than project support.<sup>184</sup> In addition to the text of the regulations and the legislative intent, there are a variety of policies that make it prudent to allow an interpretation of the expenditure responsibility requirements that includes an option for general support grants. Grantee organizations are much closer to the fields they support, and are much more knowledgeable about the intricacies of the issues they support than most funders.<sup>185</sup> Combined with the reality that the fields in which charitable organizations work are often complex and ever-changing, for grantees to be effective they require some modicum of control over how to adjust funds throughout the course of project implementation.<sup>186</sup> Providing grantees that space to determine how funds are spent allows grantee organizations to adjust to realities on the ground and switch course mid-stream when necessary in order to foster greater impact and promote better results.<sup>187</sup>

In a similar vein, funders who take a longer-term view of the change they are trying to foster in society recognize the importance of strong civil society actors. General support helps to strengthen organizations.<sup>188</sup> By allowing the grantee the flexibility to fund a key

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184. See, e.g., Alex Daniels, *Few Foundations Offer Grants to Deal with the Unexpected*, OPEN ROAD ALLIANCE (Feb. 1, 2016), <http://openroadalliance.org/few-foundations-offer-grants-to-deal-with-the-unexpected/> [https://perma.cc/FR8T-ZEQ5]; MCCRAY, *supra* note 10, at 7; *Unrestricted Core Support: Strengthening the Capacity of Our Nonprofit Sector*, *supra* note 12; *The Beauty of the General Support Grant*, *supra* note 10.

185. See, e.g., *The Beauty of the General Support Grant*, *supra* note 10.

186. See *Supporting Grantee Capacity: Strengthening Effectiveness Together*, *supra* note 92, at 17–18.

187. See *id.*

188. See, e.g., *General Operating Support (or Unrestricted) Grants*, *supra* note 12; MCCRAY, *supra* note 10, at 7; *Unrestricted Core Support: Strengthening the Capacity*

project, the use of general operating costs (including training for staff), or even the flexibility to shift funds around when new donors are acquired, general support funds can play a key role in helping organizations to strengthen their overall capacity and effectiveness.<sup>189</sup> By limiting the types of grants that organizations can receive under expenditure responsibility rules, the IRS would be working against its own stated interests—to allow charitable giving, but to do so in a way that is most impactful and responsible given the non-taxable nature of the funds.<sup>190</sup>

It is also important to revisit some of the important aspects of foundation contributions outlined earlier; specifically, foundations play a key role in our society as incubators and experimenters, providers of services that the government cannot or chooses not to provide, as well as key contributors to civil discourse.<sup>191</sup> By arming foundations with the ability to provide the most effective support possible to grantees, the positive impact that foundations can have on our domestic and global society is only increased. Unfortunately, expenditure responsibility has generally had the opposite effect: pushing foundations to fund pre-existing, stable NGOs that have been around for a long time, rather than the innovative, new, emerging organizations with fresh ideas.<sup>192</sup> Specifically,

the E[xpenditure] R[esponsibility] provision has been criticized as being unduly burdensome, especially for small foundations which lack administrative capacity to fulfill these requirements. It is said that it is easier for large foundations to supervise a few large grants rather than to orchestrate the paperwork on a number of small grants. E[xpenditure] R[esponsibility] is said to encourage routine, status quo grants.<sup>193</sup>

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*of Our Nonprofit Sector*, *supra* note 12; *The Beauty of the General Support Grant*, *supra* note 10.

189. *See Supporting Grantee Capacity: Strengthening Effectiveness Together*, *supra* note 92, at 10–11.

190. *See supra* Section II.A.

191. *See supra* Section I.A.

192. *See* Labovitz, *supra* note 46, at 84 (“[T]he provision is adversely affecting new initiatives, especially involving poor, ghetto, and minority groups.”); MOORE, *supra* note 174, at 67–68.

193. SUBCOMMITTEE ON OVERSIGHT OF THE COMMITTEE ON WAYS AND MEANS, 98th Cong., DEVELOPMENT OF THE LAW AND CONTINUING LEGAL ISSUES IN THE TAX TREATMENT OF PRIVATE FOUNDATIONS 50 (Comm. Print 1983).

In other words, expenditure responsibility has “provided a rationale for the continuance of conservative grant-making practices”—a reality that certainly needs to be changed, particularly given changes in the global context since the passage of this law.<sup>194</sup>

### 2. *The Use of the Term “General Support” Matters*

The ability to use the framework and language of “general support” is also important. Though similar flexibility and autonomy *can* be provided to grantees through a project support grant, foundations legally can jump in to influence grantee activities at any point; with general support, the foundation is obligated to honor the grantee’s autonomy (unless the foundation is willing to risk legal exposure by not remaining within the general support safe harbor). The terminology holds value: “general support” as a phrase means something specific, and the more that this term—a proxy for the concepts of flexible funding, grantee autonomy, and an awareness and leveling of the power dynamic between funder and grantee—can be utilized, the better.

### 3. *The Policy Concerns Laid Out by Lawmakers Are Better Addressed by Interpreting Expenditure Responsibility to Allow for General Support Grants*

Despite the supporting factors noted above, the legislative history also reflects skepticism among some lawmakers of more flexible grant making approaches.<sup>195</sup> However, providing greater autonomy to grantees more effectively counters any mistrust in foundations than does limiting the discretion that foundations can pass on to grantee organizations: Grantees are much closer than foundations to the issues on which they engage and the communities they support, which increases grantee responsiveness and accountability to the public due both to their proximity to the field and their reliance on donations as compared to foundations.

In a similar manner, the Tax Reform Act sought to increase the amount of funds that were available for the public good, rather than utilized for self-aggrandizement or foundation overhead costs.<sup>196</sup>

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194. Labovitz, *supra* note 46, at 78–79.

195. *See generally* H.R. Rep. No. 91-413, at 1679 (1969); S. Rep. No. 91-552, at 2040–41 (1969).

196. *See, e.g.*, STAFF OF THE J. COMM. ON INTERNAL REVENUE TAX’N, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, at 3–4 (Comm. Print 1970); HOLCOMBE, *supra* note 25, at 172.

However, both the actual and perceived strict nature of the expenditure responsibility requirements has resulted in “increased expenses for legal services and a greater reliance on counsel,” making large foundations with high overhead more viable than smaller foundations with lower overhead, and running counter to Congress’ stated purpose.<sup>197</sup> Therefore, by allowing and even clarifying the more flexible potential for expenditure responsibility, the impact of the law and regulations can become more in-line with the stated intention.

*4. Developments in Practice Suggest General Momentum  
Towards Greater Numbers of General Support Grants*

Over time, the IRS regulations have taken on a life of their own. Foundation practice has evolved and certain practices have become the understood, de facto approach even if not expressly stated. For example, the expenditure responsibility regulations require that grantees “establish separate *accounts*” for funds that have expenditure responsibility requirements tied to them.<sup>198</sup> However, given the challenges (such as high levels of bureaucracy or unwanted government attention) and expense that some organizations face in opening new accounts, it has become standard practice that a foundation will consider the maintenance of separate *accounting* by the recipient organization sufficient to meet this requirement.<sup>199</sup>

The IRS has also relaxed a series of regulations regarding grant making activity in a manner that indicates a loosening of the restrictions on foundation activity generally.<sup>200</sup> This reduction in scrutiny or skepticism of foundation activities aligns with and potentially supports the allowance of more flexible interpretations of the expenditure responsibility regulations. For example, over the past two decades, the definition of “charitable” has been expanding in nature, signaling that the IRS and even the American public prefer that a wider array of activities be considered pursuant of the public good and to receive the benefit of the charitable tax exemption.<sup>201</sup>

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197. Labovitz, *supra* note 46, at 78, 82 (observing that expenditure responsibility has “generated more foundation paperwork than any other provision of the Act). *But see id.* at 79–80 (professing that the costs of initial implementation will subside over time, as foundations “routinize” the process and establish procedures).

198. 26 C.F.R. § 53.4945-5(c)(3) (2015) (emphasis added).

199. Interview with Nicole Campbell, *supra* note 58.

200. *See SANDERS, supra* note 22, at 296.

201. *See id.*

This also indicates an increasing trust in the nonprofit sector, thereby paralleling the notions that less heavy regulation is warranted.

A more recent example: the IRS has issued new regulations that allow for greater investments in projects that both serve a charitable purpose but that also present an opportunity for income for the foundation.<sup>202</sup> Particularly given the (earlier described) skepticism of foundation wealth, this represents a clear departure from past practice and regulation of foundations.

In all of these cases, these changes are for pragmatic reasons: the IRS recognizes that when process meets practice, certain requirements will have to be flexible. Given the importance of general support grants—as well as their express mention in the regulations covering expenditure responsibility—it is reasonable to believe that the responsible provision of general support grants within the expenditure responsibility requirements falls within this category.<sup>203</sup>

##### *5. Arguments Against Interpreting Expenditure Responsibility Rules to Allow General Support Grants*

On the other hand, there are a number of arguments for why the IRS and foundations should not interpret or allow general support grants when operating under the expenditure responsibility rules.

First and foremost is ensuring that tax-exempt funds be expended for appropriate purposes: charitable activities.<sup>204</sup> This takes on particular importance when considering that expenditure responsibility grants go to organizations that are not traditional public charities: “In the abstract, this certainly appears reasonable. If organizations are going to enjoy a favored legal status, then they must contribute something toward the public interest in exchange for that favored status.”<sup>205</sup> Some lawmakers fear that subversive activities or

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202. Alex Daniels, *IRS Issues Rules Favorable to Foundations on Program-Related Investments*, CHRON. OF PHILANTHROPY (Apr. 22, 2016), [https://philanthropy.com/article/IRS-Rules-Give-Foundations/236225?cid=pt&utm\\_source=pt&utm\\_medium=en&elqTrackId=f48efb37c4f441d1923feae533cfb90c&elq=3376f8d66578490dae3b2806fd377c9c&elqaid=8790&elqat=1&elqCampaignId=2978](https://philanthropy.com/article/IRS-Rules-Give-Foundations/236225?cid=pt&utm_source=pt&utm_medium=en&elqTrackId=f48efb37c4f441d1923feae533cfb90c&elq=3376f8d66578490dae3b2806fd377c9c&elqaid=8790&elqat=1&elqCampaignId=2978) [https://perma.cc/FAW8-LD33].

203. While this may seem straightforward to some, recall that accepted foundation practice is to provide only project support grants when funding under expenditure responsibility requirements. *See supra* Section II.A.

204. *See* HOLCOMBE, *supra* note 25, at 48–49.

205. *Id.*

even terrorism will be funded with charitable dollars unless strict enforcement exists.<sup>206</sup>

It is important to understand that this concern—as well as others, stated in later portions of this section—often stems from, and is exacerbated by, a mistrust of foundations. As Randall G. Holcombe, a Professor of Economics at Florida State University, states well in his book *Writing Off Ideas*:

the primary problem from a public policy standpoint is that [f]oundation trustees have a tremendous amount of wealth at their disposal that they can spend as they see fit. While they are charged with acting in the public interest, they are accountable to nobody.<sup>207</sup>

In fact, there is evidence from the legislative history of the expenditure responsibility bill that, prior to the Tax Reform Act of 1969, there were insufficient rules in place to ensure that private foundations were making grants to support exempt purposes only.<sup>208</sup> Because of this, some lawmakers prefer that the government retains strict control over the types of grants that foundations can make, limiting the scope of discretion afforded to foundations.<sup>209</sup> Though the value of general support grants is that *grantees*, not foundations, are ultimately afforded greater flexibility and autonomy in how they utilize grant funds, foundations do receive an interim increase in discretion when serving as the necessary intermediary in the disbursement of grant funds: Foundations are afforded the opportunity to determine for which organizations it is appropriate and reasonable to provide an expenditure responsibility grant, as well as when it is appropriate and reasonable to provide grantees with flexibility through a general support grant.<sup>210</sup>

This lack of trust extends even further than just the assurance that foundations fund exempt purposes only.<sup>211</sup> As Holcombe states in *Writing Off Ideas*,

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206. See NORTON, *supra* note 17, at 52; SANDERS, *supra* note 22, at 1253.

207. HOLCOMBE, *supra* note 25, at 2.

208. See, e.g., H.R. Rep. No. 91-413, at 1646–49 (1969) (exploring the ways in which insufficient regulation has led to inappropriate activities by some Foundations); see also HILL & MANCINO, *supra* note 41, at 11-78 to 11-92.

209. See generally H.R. Rep. No. 91-413 (1969).

210. Revisit the PGI requirements, described in 26 C.F.R. § 53.4945-5 (b)(2) (2015), which explain each of the decision-making points for a foundation when considering an expenditure responsibility grant. In these moments, foundations do experience a temporary increase in autonomy and authority, as these decisions are made at the discretion of foundation staff and/or trusted advisors.

211. In fact, this ongoing skepticism of foundations derives from a clear political bent. The Tax Reform Act of 1969 was the culmination of over a decade of inquiry by two skeptical lawmakers who were disturbed by the potential impact that

[there are] two reasons why foundations might warrant closer scrutiny than other charitable organizations. First, they are often established with the idea of providing more donor direction funds than a typical charity, and second, the funds may be put to more imaginative or unconventional uses, which naturally will raise the question of the degree to which the public interest is served by the [f]oundation.<sup>212</sup>

Though in some ways these are justifiable concerns, foundations operate in a regulatory environment that ensures the use of tax-exempt funds for charitable purposes only. Not only are there requirements about what constitutes a charitable expenditure (which includes the expenditure responsibility rules), but foundations also have to adhere to strict annual disbursement requirements, board membership requirements, anti-terrorism regulations, and a variety of other features that, if circumvented, will result in excise taxes for both the foundation itself and the individual trustees of the organization.<sup>213</sup> In the case of expenditure responsibility grants, specifically, the IRM expressly states that the purpose of expenditure responsibility is to “impose restrictions which are substantially equivalent to the limitations placed on domestic private foundations by IRC 4945(d).”<sup>214</sup> Given the breadth and effectiveness of the restrictions in place, it seems reasonable to balance potential risks and rewards in a way that allows for greater flexibility to the ultimate grant recipients.<sup>215</sup> For example, in light of the global trend to restrict civil society space, more and more organizations are being forced to register as for-profit enterprises despite having a solely charitable purpose in the eyes of U.S. tax law; this alone provides great impetus to trust that the regulations currently in place allow foundations to

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foundations could have on public discourse. It is no coincidence that this inquiry ran in parallel with McCarthyism: a period in American history marked by general skepticism and concern about subversive activities by liberal elites. Specifically, lawmakers were disturbed at the impact that foundations could have over public policy, and the 1969 Tax Reform Act was a clear response to this political influence. Those same lawmakers were skeptical that foundations were working in the public interest, and were able to argue that it was unfair for foundations to wield the level of influence they were, given that the resources of most other actors seeking to engage in public policy debate paled in comparison. *See generally* H.R. Rep. No. 91-413 (1969); S. Rep. No. 91-552 (1969); H.R. Conf. Rep. No. 91-782 (1969), reprinted in 1969 U.S.C.C.A.N. 2391, at 2392; GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, *supra* note 196, at 3; SANDERS, *supra* note 22, at 100–02.

212. HOLCOMBE, *supra* note 25, at 8.

213. *See, e.g.*, 26 U.S.C. §§ 4942, 4945 (2014).

214. IRM 7.27.19.6.9 (Feb. 22, 1999).

215. *See, e.g.*, Frumkin, *supra* note 155.

provide greater flexibility to international organizations where appropriate.

The third main concern is the notion that tax exemption for foundations makes foundation funds subsidized by taxpayers and, therefore, public money. However, this is categorically untrue. Foundations are not established to be agents of the state, and in fact are intentionally designed to be able to tackle issues and challenges that the government otherwise cannot or will not address.<sup>216</sup> In addition, foundation money is donated by private individuals, and tax exemption is granted in exchange for dedicating the organization's efforts to public—rather than private—benefit.<sup>217</sup> The State's power of regulation over foundations and other charitable organizations should not be conflated with the decision-making authority of private individuals in determining how foundation assets are spent: the State has the power to regulate but, just as is true with private corporations, individuals still retain decision-making authority.<sup>218</sup>

A related concern to this notion that tax-exempt dollars are funds subsidized by the general public is a desire for those tax-exempt, “publically subsidized” funds to remain within the United States, to focus on fostering social progress domestically.<sup>219</sup> Some lawmakers fear that if expenditure responsibility rules were to relax, the funding of foreign organizations would become so easy that foreign issues would draw much-needed funds that would otherwise be applied towards domestic issues.<sup>220</sup> Though in some ways this concern cannot be quelled for those who find this argument compelling, it has been shown that the betterment of global welfare has important impacts for domestic well-being as well, meaning funds spent on charitable activities abroad *do* in fact offer domestic benefit.<sup>221</sup>

In response to all of these concerns, time has shown that foundations work consistently in the public interest, and relatively few abuses exist among modern foundations (if they ever existed at all).<sup>222</sup> As the *Chronicle of Philanthropy* has proclaimed: “Foundations have grown into profoundly public institutions, open

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216. See *supra* Section I.A.

217. See HOLCOMBE, *supra* note 25, at 49–50.

218. See EVELYN BRODY & JOHN TYLER, HOW PUBLIC IS PRIVATE PHILANTHROPY? SEPARATING REALITY FROM MYTH 29, 34 (1st ed. 2009).

219. See Zolt, *supra* note 174, at 368.

220. See *id.* at 379.

221. See *generally id.* at 380.

222. See *generally* Frumkin, *supra* note 155.



and transparent to all.”<sup>223</sup> The purpose of foundation regulations was to protect against self-dealing or private benefit from public tax exemption; the unintended consequence of limiting grantee flexibility is not necessary to achieve these goals. The drafters’ own language can now be used against them: “although the tax preferences may have been justified at the time of their inception, it is not clear that they are needed or desirable in today’s economy.”<sup>224</sup> Though perhaps this clampdown on foundations was necessary in the late 1960s, the rare misuse of funds by foundations means these requirements might be outdated. Therefore, it is time to make clear that expenditure responsibility requirements have room for flexibility, and that the IRS will respect that discretionary space.

### III. APPROACHES FOUNDATIONS CAN TAKE TO PROVIDE GENERAL SUPPORT GRANTS WHILE OPERATING UNDER EXPENDITURE RESPONSIBILITY REQUIREMENTS

When a law is complicated or the lines it draws are indistinct, there is a normal tendency to steer clear of any activity that involves the risk of a violation. In the case of the foundation provisions, the penumbra of the law reaches most of what foundations claim they are or should be doing—innovative grants, seed money grants, grants that will influence social policy. Relatively few foundations have sufficiently sophisticated staffs—or a deep enough commitment to these activities—to persevere when the legality of what they are contemplating is in doubt. For many foundations, the 1969 law is a refuge; it provides a rationale for continuing their traditionally conservative activities despite the urgings of leaders in the field to become more venturesome and bold.<sup>225</sup>

Despite the lack of particular guidance in the U.S. Code and the C.F.R., and foundations’ risk-averse approach to grant making under expenditure responsibility, the law does affirmatively state that general support is possible under expenditure responsibility.<sup>226</sup> Therefore, there must be a way for foundations to remain within the expenditure responsibility requirements while also providing grantees with much-needed flexibility through general support grant making. Part III explores potential approaches to providing general support while adhering to the expenditure responsibility requirements,

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223. *Id.*

224. H.R. Rep. No. 91-413, at 1653 (1969).

225. Labovitz, *supra* note 46, at 80.

226. 26 C.F.R. § 53.4945-5 (2015); *see* IRM 7.27.19.3.11, 6.1, 6.7 (Feb. 22, 1999).

followed by a recommendation for clarifying updates to the C.F.R. and I.R.M. that confirm the acceptability of making general support grants under expenditure responsibility.

### A. Possibilities Under the Existing Legal Framework

In order to develop potential approaches to general support grant making under expenditure responsibility, it is important to remember two things: the purposes for making a general support grant rather than a project support grant, and the mechanics of the general support safe harbor. Ultimately, a general support grant allows the grantee to remain in control of how funds are spent, allowing for greater flexibility and responsiveness in implementation of their strategy that can result in greater impact and a stronger organization. The key element of a general support grant is that funds are not (in reality or based on perception) earmarked by the foundation for any particular activities or outcomes. Avoiding earmarking funds for particular purposes is necessary in order to remain safely within the general support safe harbor. With this in mind, this Note suggests three main ways that a foundation could make a general support grant under the existing expenditure responsibility requirements. The following recommendations are intended to apply to international organizations that lack equivalency determination<sup>227</sup> yet are charitable in nature.

#### 1. *Potential Approach 1: Removing the Need for the General Support Safe Harbor*

The first approach examines and questions the underlying necessity of the general support safe harbor. The protection provided by this safe harbor is only necessary when a grantee conducts any amount of lobbying or other prohibited activities<sup>228</sup>; if, at the end of a grant term, the organization conducted no lobbying or other prohibited activities, attaining the general support safe harbor is a moot point. Therefore, foundation staff should feel comfortable providing an expenditure responsibility general support grant to an organization that the foundation knows only conducts charitable activities and will not conduct any lobbying or other prohibited activities. This trust can be developed through the PGI process, and confirmed in the written grant agreement required by expenditure responsibility rules. The

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227. Recall the many reasons an organization may lack equivalency determination. See *supra* Section I.C.

228. See *supra* Section I.C.2.

requisite financial reporting can be satisfied with reports that remain consistent with the standard interpretation of general support reporting requirements: that expenditures not be attributed to any particular funding sources in order to avoid the appearance of earmarking. Because—as both the proposal and final reports confirm—no prohibited activities were conducted by the grantee, it is unnecessary to clarify which activities were funded with the expenditure responsibility funds: all expenditures would be considered acceptable by the IRS. This option is the most straightforward and presents little risk for foundations, but will only be possible in a limited number of circumstances.

## *2. Potential Approach 2: Bifurcated Budgets*

A second potential approach to general support grant making within the confines of expenditure responsibility acknowledges the fungible nature of an organization's funds. In fact, the IRS itself acknowledges the fungible nature of assets in the creation of the general support safe harbor.<sup>229</sup> To extrapolate this further: If, during the proposal stage of a general support grant, an organization submits a projected budget that includes certain prohibited activities, the grantee can be asked to bifurcate the budget. If the organization can show that the total funds projected to be spent on non-prohibited activities is higher than the amount of the potential grant, a general support grant should be considered possible. After clear conversations and perhaps training on prohibited expenditures, the required PGI can be used to establish sufficient trust regarding an organization's understanding of prohibited uses for the grant funds and that funds used for prohibited expenditures will need to be returned. Of course, this understanding will be confirmed in the mandatory written grant agreement. At the same time, the foundation retains the general support safe harbor because they are not earmarking funds for particular purposes: the grantee has full control to determine how funds are spent within the broad category of appropriate, charitable expenditures. If a foundation desires to reduce risk in this scenario a little further, it might then ask for the final financial reports to show how the prohibited expenditures were covered by funds other than those of the expenditure responsibility grant. That way, the foundation can avoid both earmarking funds at the beginning of the grant and the perception of having earmarked funds through the request of attribution in the final reports. It is

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229. See *supra* Section I.B.2.

important to note that this approach is not novel, and is often used in the project support context;<sup>230</sup> however, it seems possible to replicate this in the general support context as well.

This potential approach becomes complicated if a significant portion of the organization's projected expenditures consist of prohibited activities or non-charitable expenditures. In those cases, earmarking by the foundation could be considered to have occurred by default. For example, if an organization is planning to run ten projects of roughly equivalent budget sizes, but nine of them are lobbying-based and only one is not, taking this approach would, in effect, mirror a foundation earmarking funds for that particular project (in this case, a mere ten percent of possible activities). This clearly goes against the spirit of general support grant making, and would not warrant valid application of the general support safe harbor. Therefore, a foundation must exercise discretion in determining when taking this approach would still provide sufficient flexibility and decision-making authority to the grantee. Though not current law, the IRS might consider extending the *de minimis* exception relevant to registered 501(c)(3) public charities or delineating alternative proportions or percentages—such as a fifteen percent maximum in lobbying or other prohibited expenditures—that would allow foundations to provide general support through this method with more confidence. This percentage approach is strengthened when one considers that this same approach is used in other aspects of foundation law: a threshold test is used to determine whether an organization is eligible to become a 501(c)(3) non-profit.<sup>231</sup> Appendices C, D, and E illustrate sample expenditure responsibility proposals and reports that align with this potential approach.<sup>232</sup>

### 3. *Potential Approach 3: De-Linking Funds from Specific Project Activities or the All/But Approach*

A third potential approach to making a general support grant within the confines of current expenditure responsibility requirements utilizes a variation on the negotiated general support approach, and goes a step further than the second approach outlined above. Recall that with negotiated general support, a foundation can make it clear what they *do* want a grantee organization to do throughout the grant

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230. Interview with Nicole Campbell, *supra* note 58.

231. *See Knowledge Base*, *supra* note 7.

232. *See* Appendices C–E.

term but, by de-linking the use of the grant funds from helping to further those particular projects or outcomes, the foundation stops short of tying the funds to particular purposes and can remain within the spirit of general support grant making while also retaining the general support safe harbor.<sup>233</sup> A series of possibilities for general support grant making under expenditure responsibility become possible if a foundation takes the negotiated general support approach and inverts it: rather than telling an organization what they should do, foundations could explain merely what they cannot do. This way, foundations could ensure that potential general support grantees retain a high level of control over how funds are spent, yet also be sure that activities include “everything except” or “all but” prohibited expenditures. This departs from the control and earmarking to particular outcomes and budget lines present in project support grant making, where the grant is for “only this.”

This all/but approach falls within the boundaries of acceptability for both general support grants and expenditure responsibility. With regards to general support, the grantee retains decision-making control over two key aspects: one, the activities that they choose to conduct and, two, how the funds are expended within the broad limitations of not spending funds on prohibited expenditures. Combined, these offer the grantee great autonomy and latitude. Prior training on appropriate expenditures can, again, be provided by the foundation, and the understanding can be confirmed through the PGI and written grant agreement. Expenditure responsibility-compliant reporting can take either the approach outlined above, or can show how foundation funds were expended for non-lobbying purposes. Because the crucial aspect of general support grant making is that funds are not tied to particular projects or outcomes at the outset, it seems acceptable to consider reporting that shows foundation funds were expended on acceptable purposes after the fact, as long as there was no prior earmarking of funds.<sup>234</sup>

The value of the all/but approach is that it can apply to the greatest number of situations; however, it also presents a variety of potential burdens and risks. For example, this approach would require a certain level of training for the grantee in order for the foundation to build sufficient confidence that the grantee knows what activities to avoid with the foundation's funds. In addition, this approach presents the same threshold problem as noted above: The foundation will have

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233. *See supra* Section I.B.2.

234. This suggestion is a bit more extreme, but could technically apply to all three suggested scenarios.

to exercise discretion about whether, based on the percentage breakdown of the organization's activities, there remains a sufficient percentage of acceptable uses for the expenditure responsibility funds that there is still true decision-making authority for the grantee organization about how those funds are expended, thereby allowing the foundation to avoid the actual or perceived earmarking of funds for particular purposes. Ultimately, this approach requires a foundation to feel comfortable that detailed reporting at the end of a grant does not lend the perception of under-the-table earmarking at the beginning of a general support grant.

However, the fact that foundations are not responsible for the failure of a grantee to adhere to expenditure responsibility obligations supports the idea that lawmakers retained some trust in foundations' commitment to promoting the public good, and are to be given some discretion in how they conduct their grant making activities. This discretion can be used to determine the appropriate level of depth for the PGI or, perhaps, to determine when a grantee organization might be sophisticated enough to manage an all/but approach to an expenditure responsibility general support grant. This determination can be easily documented in the PGI documents. Appendix F contains a sample grantee report for this potential approach.<sup>235</sup>

#### **B. Recommendations for Minor Adjustments to the C.F.R.**

As referenced above, there are a variety of minor clarifications and updates that the IRS could make to the C.F.R. and the I.R.M. that could help to clarify how to approach general support grant making in a manner that upholds the expenditure responsibility requirements yet also provides grantees with greater discretion and control over grant funds.

First, the IRS could issue a general statement that clarifies that general support can, in fact, be made under expenditure responsibility, as the regulations state. Specifically, the IRS should state that, should the expenditure responsibility requirements (PGI, written proposal, signed grant agreement, final reports, and foundation disclosure to the IRS) be satisfied, the IRS will accept that general support grants are in alignment with existing law and policy, and will not undertake further enforcement action.

Second, the IRS could amend the C.F.R. and the I.R.M. to include further guidelines that clarify how general support grants can be made under expenditure responsibility, perhaps utilizing the three

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235. See Appendix F.

potential approaches illustrated above. It is important to note that these clarifications would not only remain in alignment with the currently existing regulations, but would require no amendments to be made to the U.S. Code. Therefore, this falls solely within the ambit of the IRS.

Specifically, the IRS should provide for a general support safe harbor in the case of expenditure responsibility general support grants if the grantee conducts merely a *de minimis* amount of lobbying activities or other prohibited expenditures, in the same way that the IRS provides this safe harbor for general support grants to 501(c)(3) organizations and equivalents that conduct a *de minimis* amount of lobbying or other prohibited expenditures. As described earlier, many organizations that might otherwise be eligible to receive equivalency determination cannot or do not pursue that option, not because they conduct non-charitable activities, but because of language barriers or lack of capacity. Therefore, creation of the general support safe harbor would support the funding of those smaller, grassroots organizations: not the funding of activities and organizations otherwise considered not to be charitable.

In addition, the IRS could also honor the *de minimis* exception in the case of international organizations that would otherwise be considered a 501(c)(3) or equivalent. This approach would support a pragmatic understanding of both the many reasons why foreign organizations do not acquire equivalency determination status *and* that money is fungible.

If the IRS is willing to consider adjustments that represent slight departures from past practice (rather than simply a clarification of the current regulations), the agency could also begin to accept attribution in general support grant reports to particular foundation funds in the limited scenario of a general support grant under expenditure responsibility to a foreign organization. Based on the justification that the crucial aspect of a general support grant is that grant funds are not tied to particular activities at the outset, not that the foundation remains fully unaware of how their funds were spent at the close of the grant, this would allow foundations to use the all/but approach outlined above without the concern that requesting financial reports with attribution would somehow generate the perception of earmarking.

By taking any or all of these suggestions, the IRS would be clear about its intention to allow general support grant making in the context of expenditure responsibility. By being clear, they would encourage foundations to make a higher number of general support

grants, knowing that they are not at risk of having to pay excise taxes or, in the worst case, losing their exempt status.

### CONCLUSION

Providing grantees with unrestricted, flexible funds through general support grants is crucial to fostering greater social impact, prompting innovation, and supporting the development of strong organizations. Given the plain text and policy intentions of the expenditure responsibility regulations—as well as the broad and effective regulatory framework in which foundations reside—it is reasonable to interpret said regulations in a manner that allows the use of general support. The time has come for foundation managers, legal counsel, and even the IRS to take a fresh look at the expenditure responsibility requirements and act on the potential that general support grant making offers. Whether it be through expanded use of the general support safe harbor or by taking an all/but approach to funding, foundation staff have a variety of options to match varying levels of risk appetite for using general support under expenditure responsibility, even in lieu of any formal clarifications by the IRS. With this approach, foundations will better equip grantee organizations to take-on and succeed in meeting the real-world challenges of their social missions, such as expanding human rights, fostering arts and culture, improving public health, and expanding education worldwide.



**APPENDIX A: EXPENDITURE RESPONSIBILITY REQUIREMENTS<sup>236</sup>**

The expenditure responsibility requirements, as laid out in 26 U.S.C. § 4945 and associated regulations, provide:

Expenditure responsibility means that the Foundation exerts all reasonable efforts and establishes adequate procedures:

1. To see that the grant is spent only for the purpose for which it is made,
2. To obtain full and complete reports from the grantee organization on how the funds are spent, and
3. To make full and detailed reports on the expenditures to the IRS.

... and may involve one or more of the following elements:

1. Pre-grant inquiry
2. Certain commitments by the grantee
3. Requirements relating to program-related investments
4. Actions with respect to violations of expenditure responsibility requirements

To meet the expenditure responsibility requirements, each grant must be made subject to a written commitment signed by an appropriate officer, director, or trustee of the grantee organization. This commitment must include the following agreements by the grantee:

1. To repay any amount not used for the purposes of the grant,
2. To submit full and complete annual reports to the grantor foundation on the manner in which the funds are spent and the progress made in accomplishing the purposes of the grant,
3. To keep records of receipts and expenditures and to make its books and records available to the grantor at reasonable times and
4. Not to use any of the funds to influence legislation, to influence the outcome of elections, to carry on voter registration drives, to make grants to individuals or other organizations or to undertake any nonexempt activity, when such use of the funds would be a taxable expenditure if made directly by the foundation.

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236. 26 U.S.C. § 4945 (2014); 26 C.F.R. § 53.4945-5 (2018).

### APPENDIX B: SAMPLE EXPENDITURE RESPONSIBILITY FINANCIAL REPORT

The following sample financial report illustrates how a grantee can demonstrate to a foundation funder that foundation funds were spent only on permitted activities. In this sample, the grantee shows that Foundation *A* funds were spent on non-lobbying activities associated with “Project *A*.” The corresponding narrative report would describe the “Project *A*” activities in more detail, allowing a Foundation to confirm that the grantee used the funds on permitted expenditures only. In this scenario, the only funds with expenditure responsibility restrictions attached are those from Foundation *A*.

	Projected	Actual	Fdn A	Govt Grant	Gen'l Fund	Reserves
<b>Personnel</b>	180,000	180,000		150,000	30,000	
<b>Office Rent</b>	20,000	20,000			20,000	
<b>Utilities</b>	10,000	9,800			9800	
<b>Travel</b>	10,000	9,500		9500		
<b>Project A</b>						
Lobbying	70,000	73,000				
Activity 1	35,000	34,500			34,500	
Activity 2	35,000	38,500			38,500	
Non-Lobbying	110,000	107,000				
Activity 1	25,000	32,000	32,000			
Activity 2	25,000	19,000	19,000			
Activity 3	25,000	26,500	26,500			
Activity 4	35,000	29,500	22,500		7000	
<b>TOTAL</b>	180,000	180,000				

	Projected	Actual	Fdn A	Govt Grant	Gen'l Fund	Reserves
<b>Project B</b>						
Lobbying	50,000	38,000				
Activity 1	50,000	38,000		38,000		
Non-Lobbying	50,000	62,000				
Activity 1	50,000	62,000		62,000		
TOTAL	100,000	100,000				
<b>Project C</b>						
Lobbying	0	0				
Non-Lobbying	100,000	102,000				
Activity 1	55,000	53,000			53,000	
Activity 2	15,000	17,500		15,000	500	2000
Activity 3	30,000	31,500		5,500	26,000	
TOTAL	100,000	102,000				
GRAND TOTAL	600,000	601,300	100,000	280,000	219,300	2000

“Fdn A” = Foundation A

“Govt Grant” = Government Grant

“Gen'l Fund” = general donations, made by private individuals, that the organization can use as they please

“Reserves” = the grantee's reserve fund

**APPENDIX C: SAMPLE EXPENDITURE RESPONSIBILITY PROPOSAL**

This sample expenditure responsibility grant proposal provides a projected organizational budget. The organization bifurcates the budget, demonstrating their understanding of U.S. funding restrictions. If Foundation A were considering a \$100,000 grant to this organization, they can feel comfortable knowing that there are sufficient ways that the organization can spend those funds on permitted (e.g., Non-Lobbying) activities.

	Projected Organizational Budget
OVERHEAD	
Personnel	200,000
Office Rent	25,000
Utilities	10,000
Travel	15,000
TOTAL	250,000
PROJECT A	
Lobbying	20,000
Activity 1	15,000
Activity 2	5,000
Non-Lobbying	250,000
Activity 1	95,000
Activity 2	50,000
Activity 3	45,000
Activity 4	60,000
TOTAL	270,000
PROJECT B	
Lobbying	0
Non-Lobbying	50,000
Activity 1	50,000
TOTAL	50,000
PROJECT C	
Lobbying	5000
Activity 1	5,000

	Projected Organizational Budget
Non-Lobbying	95,000
Activity 1	55,000
Activity 2	15,000
Activity 3	25,000
TOTAL	100,000
Total Overhead	250,000
Total Lobbying	25,000
Total Non-Lobbying	395,000
GRAND TOTAL	670,000

**APPENDIX D: SAMPLE EXPENDITURE RESPONSIBILITY REPORT 1**

This sample expenditure responsibility financial report shows actual spending as compared to the originally projected organizational budget. Though the actual spending is slightly different than what was projected, the Foundation can see that there are many ways the \$100,000 grant could have been spent that aligns with prohibitions on funding (specifically, \$643,020 of the budget). The narrative report would confirm that the grantee *did* only apply the grant to permitted activities.

	Projected Organizational Budget	Actual Spending
Overhead		
Personnel	200,000	200,000
Office Rent	25,000	25,000
Utilities	10,000	9,800
Travel	15,000	13,400
TOTAL	250,000	248,200
PROJECT A		
Lobbying	20,000	19,200
Activity 1	15,000	13,000
Activity 2	5,000	6200
Non-Lobbying	250,000	247,300
Activity 1	95,000	94,900
Activity 2	50,000	46,200
Activity 3	45,000	45,000
Activity 4	60,000	61,200
TOTAL	270,000	266,500
PROJECT B		
Lobbying	0	0
Non-Lobbying	50,000	50,020
Activity 1	50,000	50,020
TOTAL	50,000	50,020
PROJECT C		
Lobbying	5000	2000
Activity 1	5,000	2,000

	Projected Organizational Budget	Actual Spending
Non-Lobbying	95,000	97,500
Activity 1	55,000	56,500
Activity 2	15,000	14,000
Activity 3	25,000	27,000
TOTAL	100,000	99,500
Total Overhead	250,000	248,200
Total Lobbying	25,000	21,200
Total Non-Lobbying	395,000	394,820
GRAND TOTAL	670,000	664,220

**APPENDIX E: SAMPLE EXPENDITURE RESPONSIBILITY REPORT 2**

This sample expenditure responsibility financial report demonstrates actual spending—just as in the sample provided in Appendix C—but also demonstrates how the organization covered the limited number of costs that could not be funded by the expenditure responsibility grant. This way, the Foundation has assurance that grant funds were used appropriately, while still avoiding attribution of Foundation funds that might lend the appearance of earmarking.

	Projected Organizational Budget	Actual Spending	Organization General Fund
<b>OVERHEAD</b>			
Personnel	200,000	200,000	
Office Rent	25,000	25,000	
Utilities	10,000	9,800	
Travel	15,000	13,400	
<b>TOTAL</b>	<b>250,000</b>	<b>248,200</b>	
<b>PROJECT A</b>			
Lobbying	20,000	19,200	19,200
Activity 1	15,000	13,000	
Activity 2	5,000	6,200	
Non-Lobbying	250,000	247,300	
Activity 1	95,000	94,900	
Activity 2	50,000	46,200	
Activity 3	45,000	45,000	
Activity 4	60,000	61,200	
<b>TOTAL</b>	<b>270,000</b>	<b>266,500</b>	
<b>PROJECT B</b>			
Lobbying	0	0	
Non-Lobbying	50,000	50,020	
Activity 1	50,000	50,020	
<b>TOTAL</b>	<b>50,000</b>	<b>50,020</b>	
<b>PROJECT C</b>			
Lobbying	5,000	2,000	2,000
Activity 1	5,000	2,000	



	Projected Organizational Budget	Actual Spending	Organization General Fund
Non-Lobbying	95,000	97,500	
Activity 1	55,000	56,500	
Activity 2	15,000	14,000	
Activity 3	25,000	27,000	
TOTAL	100,000	99,500	
Total Overhead	250,000	248,200	
Total Lobbying	25,000	21,200	21,200
Total Non-Lobbying	395,000	394,820	
GRAND TOTAL	670,000	664,220	

**APPENDIX F: SAMPLE EXPENDITURE RESPONSIBILITY REPORT 3**

In this sample financial report, the grantee provides a full breakdown of how they applied specific funds to specific activities. This allows Foundation A to confirm that the expenditure responsibility grant covered solely permitted costs. This is an acceptable report for a general support grant because the grantee still had the ability to choose where to spend the funds, they are simply now reporting on what decisions they made.

	Projected Organizational Budget	Actual Spending	Fdn A	Fdn B	Govt Grant	Gen'l Fund
<b>OVERHEAD</b>						
Personnel	200,000	200,000			150,000	50,000
Office Rent	25,000	25,000		2,500	10,000	12,500
Utilities	10,000	9,800				9,800
Travel	15,000	13,400			10,000	3400
<b>TOTAL</b>	<b>250,000</b>	<b>248,200</b>				
<b>PROJECT A</b>						
Lobbying	20,000	19,200				
Activity 1	15,000	13,000				13,000
Activity 2	5,000	6200				6200
Non-Lobbying	250,000	247,300				
Activity 1	95,000	94,900	50,000		44,900	
Activity 2	50,000	46,200	46,200			
Activity 3	45,000	45,000	3,800		41,200	
Activity 4	60,000	61,200			61,200	
<b>TOTAL</b>	<b>270,000</b>	<b>266,500</b>				
<b>PROJECT B</b>						
Lobbying	0	0				
Non-Lobbying	50,000	50,020				
Activity 1	50,000	50,020		50,000		20
<b>TOTAL</b>	<b>50,000</b>	<b>50,020</b>				
<b>PROJECT C</b>						

	Projected Organizational Budget	Actual Spending		Fdn A	Fdn B	Govt Grant	Gen'l Fund
Lobbying	5000	2000					
Activity 1	5,000	2,000					2000
Non-Lobbying	95,000	97,500					
Activity 1	55,000	56,500			56,500		
Activity 2	15,000	14,000			14,000		
Activity 3	25,000	27,000			27,000		
TOTAL	100,000	99,500					
Total Overhead	250,000	248,200		0	2,500	170,000	75,700
Total Lobbying	25,000	21,200		0	0	0	21,200
Total Non-Lobbying	395,000	394,820		100,000	147,500	147,300	20
GRAND TOTAL	670,000	664,220		100,000	150,000	317,300	96,920